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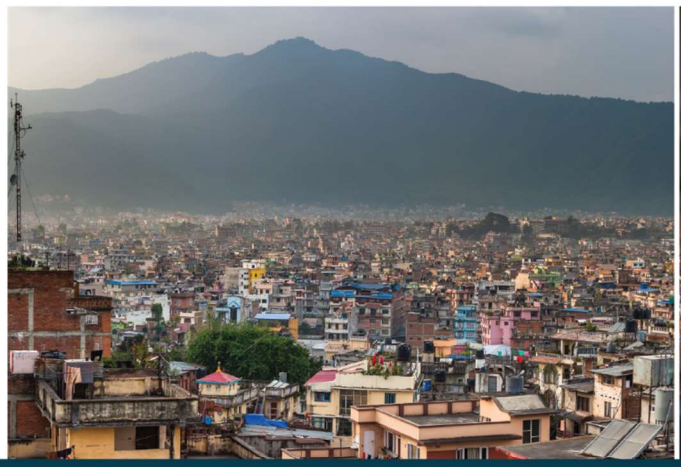

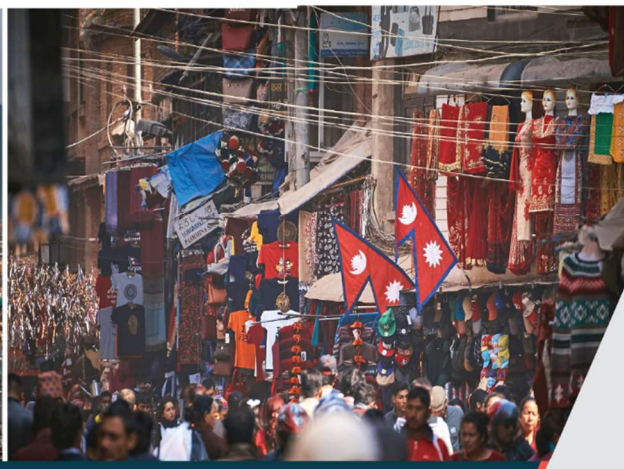

PROVINCIAL HEALTH FRA NEPAL

Client: Foreign, Commonwealth and Development Office

Nepal Health Sector Programme 3 – Procurement and Public Financial Management (PPFM)

February 2022 Contract ref: PO 7836 - Lot 3 CA ref: 106874D

Original

In partnership with

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APPENDICES

TABLES

ABBREVIATIONS

BEK	British Embassy Kathmandu
BNMT	Birat Nepal Medical Trust
CGAS	Computerized Government Accounting System
COA	Chart of Accounts
COVID	Corona Virus Disease
DPs	Development Partners
DTCO	District Treasury Controller's Office
EDPs	External Development Partners
FCGO	Financial Comptroller General's Office
FMIP	Financial Management Improvement Plan
FMoHP	Federal Ministry of Health and Population
FMR	Financial Monitoring Report
GIZ	Gesellschaft für Internationale Zusammenarbeit
GoN	Government of Nepal
IGFA	Inter Government Fiscal Arrangement Act
INGO	International Non-Government Organisation
IPFMRP	Integrated Public Financial Management Reform Programme
LMBIS	Line ministry budget information system
NGO	Non-Government Organisation
MoF	Ministry of Finance
MoEAP	Ministry of Economic Affairs and Planning
MoFAGA	Ministry of Federal Affairs and General Administration
MoSD	Ministry of Social Development
MTEF	Mid Term Expenditure Framework
NNRFC	National Natural Resource and Fiscal Commission
NPB	National Project Bank
NHSSP	Nepal Health Sector Support Programme
O&M	Organization & Management
PLMBIS	Provincial line ministry budget information system
PTCO	Provincial Treasury Controller's Office
PAMS	Public Assets Management System
PFM	Public Financial Management
PSI	Population Services International
NPSAS	Nepal Public Sector Accounting Standards
OAG	Office of Auditor General
PHD	Provincial Health Directorate
PPFM	Procurement and Public Financial Management
SPP	Sudur Paschim Province
SuTRA	Sub-national Treasury Regulatory Application
TABUCS	Transaction Accounting and Budget Control System
TSA	Treasury Single Account
UNFPA	United Nations Population Fund
UNICEF	United Nations International Children's Emergency Fund
WHO	World Health Organization

EXECUTIVE SUMMARY /

The objective of an FRA is to identify, in a structured way using a standardised approach, the potential financial management risks facing UK financial aid. It is a chance to identify areas where things could go wrong, not a review of where things are actually going wrong. It is based on a relatively short, light-touch review of a complex tier of government established in 2018/19 which has many moving parts. Due to restrictions placed on the PPFM team as a result of the Covid-19 pandemic, we have selected two provinces in the sample for this provincial health FRA. Province 2 and Sudur Paschim Province were selected in agreement with the FMoHP on the grounds that they are in receipt of TA funded by BEK and also because locally hired researchers were on site and were able to facilitate this FRA between the PPFM team and officials in the provinces in the midst of the Covid-19 pandemic. The PPFM team also noted that Province 2 had the highest proportion of audit irregularities, including serious irregularities, for both provinces as reported by the OAG.

The analysis is based on a review of the seven pillars or key areas in the public expenditure management cycle including budget reliability, transparency of public finances, and management of assets, policy-based budgeting, predictability and control in budget execution, accounting and reporting and external scrutiny and audit.

This report includes section 2 (the PFM analysis and assessment) as its main section and considers the public expenditure management arrangements that are in place in the health sector to manage resources in the provincial sphere using the 7 pillars in FCDO's SMART Guide 2021. Section 3 contains the key risks, mitigation measures and residual risks. Section 4 attempts to set out the financial and other implications of the key risks identified, either by attaching a monetary value to the risk or stating what the financial implication of the risk might be. Section 5 considers the credibility of existing PFM reforms ongoing PFM reforms in Nepal. Section 6 makes some suggestions around the importance of systematic monitoring of fiduciary risk by the FCDO, and makes suggestions for dialogue to discuss progress and any new risks that may emerge.

1. Introduction

Objectives of the FRA, methodology and approach

The objective of an FRA is to identify in a structured way using a standardised approach, the potential financial management risks facing UK financial aid. It is important to note that this FRA is not an audit, nor is it intended to identify problems in the current programme or in government execution systems. Rather, it is an assessment of risk: it is a chance to identify areas where things could go wrong, not a review of where things are actually going wrong. It is based on a relatively short, light-touch review of a complex tier of government which was established in 2018/19 which has many moving parts. Due to restrictions placed on the PPFM team as a result of the Covid-19 pandemic, we have selected two provinces, in keeping with our approved ToRs, in the sample for this provincial health FRA. Province 2 and Sudur Paschim Province (SPP) were selected in agreement with the FMoHP on the grounds that they are in receipt of TA from BEK and also because locally hired researchers were on site and able to facilitate this FRA between the PPFM team and officials in the provinces in the midst of the Covid-19 pandemic. The PPFM team also noted that Province 2 had the highest proportion of audit irregularities, and serious irregularities for both provinces as reported by the OAG.

The analysis is based on a review of the seven pillars or key areas in the public expenditure management cycle including budget reliability, transparency of public finances and management of assets, policy-based budgeting, predictability and control in budget execution, accounting and reporting and, external scrutiny and audit. These areas are explained further in the next section.

This FRA follows the most recently updated (April 2021) FCDO PrOF Guide and draws on primary and secondary data from different sources of information. The information provided in recent FCDO federal and provincial FRA/ASP assessments is also used.

The report is comprised of the following sections:

- **Executive summary (above):** Summarises the overall assessment of the fiduciary and corruption risk in the health sector in the provincial sphere in Nepal, setting out the key PFM risks identified;
- **Section 1: Introduction:** includes this summary of approach and methodology used;
- **Section 2: PFM analysis and assessment:** comprises the main section of this FRA and considers the public expenditure management arrangements that are in place in the health sector to manage resources in the provincial sphere using the 7 pillars in FCDO's SMART Guide 2021;
- **Section 3: Assessment of the risk of corruption:** analyses the main corruption risks and assesses the degree of risk;
- **Section 4: Key risks, mitigations, and residual risks:** analyses the key risks associated with health sector financial aid in the provincial sphere, taken from the PFM analysis in Section 2, in order to provide suggestions on mitigations, also identifying residual risk;
- **Section 5: The financial impact of key risks identified:** attempts to set out the financial and other implications of the key risks identified, either by attaching a monetary value to the risk or stating what the financial implication of the risk might be;
- **Section 6: Credibility of existing reforms:** briefly analyses ongoing PFM reforms in Nepal; and
- **Section 7: Dialogue and monitoring:** makes some suggestions around the importance of systematic monitoring of fiduciary risk by FCDO and makes suggestions for dialogue to discuss progress and any new risks that may emerge.

Background to provincial governments

Seven provinces were formed in Nepal on 20 September 2015 in accordance with Schedule 4 of the Constitution of Nepal. The seven provinces were formed by grouping 77 districts. Provincial governments are one of the three tiers of governance. The rights and functions of the provinces are outlined in annexes 6 and 7 of the constitution followed by several acts and regulations. Provinces

became functional from the last trimester of FY 2017/18 with the provisioning of budget for two months through federal transitional budgetary support of about NPR 1 billion to each of the provinces. Provinces in Nepal became fully functional with a full year budget from FY 2018/19. The federal resources to be made available to provinces are composed of unconditional revenues which sub-national governments can allocate as they wish (the fiscal equalization grant and revenue-sharing) and conditional, matching and special grants which must be allocated according to guidelines set by the federal government.

An overview of provincial health governance in Nepal

The health sector has been the key and major function of provincial governments in Nepal. As per the decision of the GoN in December 2018, provincial governments have been given responsibility for multiple health functions, both preventive and curative, with an institutional set up of about 250 health entities across the provinces. The MoSD has been assigned as the apex provincial ministry, responsible for health policy, planning, legislation, budgets, norms and standards, and for monitoring and evaluation of health service delivery.

Under the federal system, Nepal's publicly funded health system of hospitals and health entities/facilities are now shared between the three levels of government – federal, provincial and local. The federal level retains responsibility for 43 of the country's specialised hospitals, centers and academies (16 government health entities plus 27 autonomous/semi-autonomous health entities). The provinces are now responsible for provincial health directorates, public health laboratories, supply centres, reference laboratories, provincial hospitals, district hospitals, 15-bed hospitals and district level provincial health offices. The local or municipal level are responsible for urban and rural health centres, health posts and hospitals outside the district headquarter with less than 15 beds. The transformation in 2018/19 into a federal system presents FMoHP and the health sector with a number of challenges that will need to be carefully managed over time. Firstly, the vertical chain in overall health governance has now been radically altered. The devolved health system through federalisation has in some sense created a disconnect between staff and services at different levels of the health system. The federal structure is now more complex but confronted with many challenges in maintaining synergy and keeping important functional linkages between different tiers of health governance.

For example, some health-related delegated programmes, in particular those being implemented by the FMoHP, are undermining the province's role in managing and coordinating health programmes within their (provincial) jurisdictions. In the provincial sphere, federal agencies have also been undertaking their own health programmes in parallel with or without proper coordination with the provinces. In addition, several programmes are being delegated to provinces for implementation by some provincial health entities which are outside their budgetary framework. No consolidated information is currently available on these federal programmes. Only limited information may be available through provinces but on a scattered basis.

As per the Constitution of Nepal, the extended scale of health governance has been an important function entrusted to the provincial governments. The functions and work assigned to the Ministry of Social Development (MoSDs) as per approved works descriptions, organogram and sanctioned posts approved by the federal government through MoFAGA, have spelled out health related specific functions of all the designated spending units within the provincial jurisdiction. Provinces are now responsible for promotional, preventive and curative functions in health service delivery. The provincial MoSD is the apex organization which oversees health and other social sector service delivery in the provincial sphere.

Provincial health governance arrangements

The Ministry of Social Development (MoSD) in both the provinces (Province 2 and Sudur Paschim Province) is the lead agency overseeing health and other social sector service delivery in the provincial sphere. They have the overall responsibility for planning and budgeting for health service, and for drafting provincial health related legislation, issuing provincial health related policies, standards and

guidelines, regulating and monitoring provincial district hospitals and (>15 beds) outside district headquarters.

The MoSD health-related functions at the ministerial level are carried out through two divisions namely: the Policy, Legislation, Norms, Planning & Public Health Division; and the Hospital Development and Curative Service Division. The MoSD undertakes its health functions through different layers of health governance, which includes provincial health directorates, provincial reference laboratories, provincial health supply management centres, provincial health training centres and district-level provincial health offices. Province 2 has 27 different health entities and Sudur Paschim Province has 31 different health entities as shown in Table 1.

Table 1: Structural coverage of provincial health systems

Province	Provincial Health Directorate	Provincial Reference Lab	Provincial Health Supply Management Centre	Provincial Health Training Centre	Provincial & District Hospitals	District Health Offices	Ayurvedic Centre/ Pharmacy	Total
Province 2	1	1	1	1	7	8	8	**27**
Sudur Paschim Province	1	1	1	1	9	9	9	**31**

Provincial health sector funding: sources & funds flows

Article 204 of the Constitution has allowed for the setting up of a Provincial Consolidated Fund wherein different funds are to be deposited and Article 205 specifies the appropriations to be made through this provincial consolidated fund. The funds flow mechanisms at both federal and provincial governments are similar in terms of organisation and operation. Each of the seven provinces has its own separate fund. Those seven separate consolidated funds are managed by the Ministry of Economic Affairs and Planning (MoEAP, known as the MoF in Province 2) in the provincial sphere through the Provincial Treasury Controller Office (PTCO). Spending is done through appropriation and expenditure is charged against consolidated funds. Similar to the federal level, there is provision for charged expenditure in the provincial sphere for constitutional bodies and their units. An appropriation bill is passed by the provincial assembly for spending through its agencies.

In the provincial sphere, MoEAP provides automatic authorisation to spending line agencies through the use of the Provincial Line Ministry Budget Information System (PLMBIS). Programmes approved by PLMBIS are themselves considered as appropriation. Those funds are then disbursed through the Provincial Treasury Single accounts (P-TSA), so spending units do not need separate bank accounts. Financial reporting is done by spending units to their reporting agencies through the CGAS system. Again, as off-budget items are outside of treasury operations, these are dealt with through separate accounting and reporting processes.

2. PFM systems assessment

Introduction

The purpose of this section is to identify key fiduciary risks, based on an assessment of the financial management policies, procedures, and practices in place in the provinces as they relate to the health sector.

The key fiduciary risks identified are those risks that are likely to arise from weaknesses in assessed performance, which would have a significant impact on sound financial management in the context of FCDO's provision of financial support to the public health system in the provincial sphere in Nepal.

FCDO guidance[1] defines fiduciary risk as, 'the risk that funds are not used for the purposes intended; do not achieve value for money; and/or are not properly accounted for'. The realisation of fiduciary risk can be due to a variety of factors, including lack of capacity, competency or knowledge, bureaucratic inefficiency and/or active corruption at all levels of government.

Each of the following seven pillars (in keeping with the FCDO SMART Guide) will be reviewed in detail, with a summary of the current arrangements, followed by an assessment of the key risks.

- **Pillar 1: '**Budget reliability' looks at whether actual expenditures adhere to budget, or whether they deviate from it (and by how much). This analysis might conclude that annual planning and budgeting are weak or that, during programme implementation, controls to ensure that pre-agreed plans and budgets that are adhered to are not adequate.
- **Pillar 2:** 'Transparency of public finances' considers whether the arrangements in place adhere to existing government rules in place for transparency, including the classifications used in budgeting and reporting, and arrangements to communicate important features to citizens and beneficiaries; and whether the resources needed to deliver the programme are sufficiently predictable to enable realistic planning and budgeting.
- **Pillar 3:** 'Management of assets and liabilities' looks at the extent to which fiscal risks are recognised in asset management and whether these are guided by international best practice and standards.
- **Pillar 4:** 'Policy-based fiscal strategy and budgeting' looks at the broader budget calendar of government and how provincial health services fit into that, as well as whether a medium-term perspective is used in resource allocation decision-making, planning, and budgeting.
- **Pillar 5:** 'Predictability and control in budget execution' reviews important features of control, including financial controls for salary and non-salary transactions and controls for procurement. It also considers the existence, nature, and effectiveness of internal audit arrangements.
- **Pillar 6:** 'Accounting and reporting' looks closely at the accounting arrangements in place, including the use of accounting systems and software, management accounting and periodic and year-end financial reporting.
- **Pillar 7:** 'External scrutiny and audit' assesses arrangements in place in provinces in Nepal to audit financial statements in an effective and timely way, and what happens to address audit findings.

For each of these pillars, the FRA includes a brief description of the dimensions assessed. The summary risk ratings from the Federal ASP 2020 and the Provincial FRA 2020 are also included for each pillar for comparison purposes, as well as a text box showing the key risks for each pillar that were noted in the Provincial FRA. Each sub-section then includes our analysis and identifies key risks that may emerge, or that have materialised in the past. These 'key risks' are summarised at the end of each pillar and are then used as the basis for section 4 (key risks and mitigation measures) and section 5 (assessment of the financial implications of key risks).

Table 2 below shows which PFM/PEFA performance Indicators (PIs) have been used under each of the seven pillars in this FRA.

Table 2: PEFA pillars and performance indicators used in this FRA

Pillar	Pillars and dimensions measured		Dimensions not measured in this FRA	
1	Budget reliability:	Budget credibility and whether overall outturn and composition of	PI-3	Government revenue.

[1] FCDO Smart Guide, Fiduciary Risk Assessments, April 2021.

Pillar	Pillars and dimensions measured		Dimensions not measured in this FRA	
	PI-1 and PI-2	expenditures are in keeping with budget.		
2	Transparency of public finances: PI-4, PI-7, and PI-9	Use of appropriate budget classifications and codes; performance information on services; public access to fiscal information (transparency in resource allocation, planning, and budgeting).	PI-5, PI-6, PI-8	General budget documentation, other government operations.
3	Management of assets and liabilities: PI-12	Assets management.	PI-10, PI-11, PI 13	Fiscal risk, analysis of public investments and debt management.
4	Policy-based fiscal strategy and budgeting: PI-16, PI-17 and PI-18	Medium-term perspective in budgeting; orderliness and discipline in budget preparation; legislative scrutiny of budgets.	PI-14 PI-15	Macroeconomic forecasting and fiscal impact of policies.
5	Predictability and control in budget execution: PI-22, PI-23, PI-24, PI-25 and PI-26.	Expenditure arrears, payroll controls, procurement, internal (non-salary) controls and internal audit.	PI-19, PI-20, PI-21	Revenue administration, revenue accounts and cash accounting.
6	Accounting and reporting: PI-27, PI-28 and PI-29	Bank account reconciliations, in-year reporting, annual financial reports.	-	-
7	External scrutiny and audit: PI-30 and PI-31	Coverage, timeliness, and quality of external audit and follow-up to audit observations.	-	-

Pillar 1: Budget reliability

This pillar comprises two indicators and assesses the reliability of the original budget as a tool for decision-making. It looks at:

- aggregate expenditure outturn (PI-1), which measures how far aggregate expenditure outturn reflects the amount originally approved, as defined in budget documentation and financial reports; and

- the composition of expenditure (PI-2), which highlights changes in main budget category allocations (actual outturn compared with original budget) during the year.

Main issues identified in the Provincial FRA 2020

- The budget is not a reliable guide to expenditure. Expenditure outturns are greater than 10 percent and the budget is not linked to clear expenditure priorities. Funds may therefore not be used for their intended purpose, and/or may not achieve value for money.
- Provincial sector ministries do not have certainty in their annual appropriations as their budgets do not include co-financing by other levels of government, impacting on their ability to effectively plan and execute. Funds may not achieve value for money.
- Weak execution rates hamper the ability for effective service delivery and for growth enabling sectors to increase revenue and GDP. Value for money in the use of funds is limited.
- In-year reallocations increase potential for funds being used for unintended purposes.

Budget outturn

Budget credibility in provincial line ministries and their spending units is an area of concern in Nepal. As described in the FCDO 2020 Provincial FRA[2], total provincial budget outturn (all programmes) has been low at 54% for FY 2018/19 and 60% in FY 2019/20. In the case of Province 2, total budget outturn for the provincial government was 51% in FY 2018/19 and only 47% in FY 2019/20. Sudur Paschim Provinces' budget outturn was 57% in FY 2018/19 and 63% in FY 2019/20. These budget execution rates are extremely low.

The health sector budgets for both provinces studied for this FRA are classified into a chart of activities which has been specified by the FMoHP. This chart of health activities enables health entity wise sector/sub-sector/activity and sub-activity classification for specific budget sub-heads and economic codes, which is in keeping with the Classification of the Functions of Government (COFOG)[3].

Composition of expenditures

As per the IGFA (Section 29), transfers are not allowed from the capital budget to the recurrent budget. The Financial Procedures Act states that transfers, such as from one current budget head to another changes the budget in the same budgetary source and also changes the total budget limit, are permitted. However, the issue of total underspending of budgets is so significant that it overshadows any analysis of virements or composition of budget. The continued significant variance in actual expenditure against the budget at the level of administrative budget heads is an area of concern.

Provincial health budgets and expenditures are incurred by several types of spending unit in the provincial sphere including programmes being implemented by the MoSD itself and by the other spending units including the Provincial Health Directorate, the Provincial Health Training Centre, Provincial Health Supply Centre, Provincial Public Health Laboratory, Provincial Hospitals, District Hospitals, District level Provincial Health Offices and via Ayurved (Traditional Medicine) Offices.

Overall, budget and expenditure data for the last three years for the provincial MoSD offices is recorded in aggregate format for all sub-sectors including health and so it is not possible to separate budget and expenditure data for the MoSD for health. Also, the MoSD in Province 2 could not prepare a consolidated financial statement capturing expenditures for all provincial health entities for the FY

[2] Appendix D, FCDO Provincial FRA
[3] Developed by the OECD, the Classification of the Functions of Government (COFOG) classifies government expenditure data from the System of National Accounts by the purpose for which the funds are used.

2018/19, a major limitation in financial reporting of the MoSD. That said, some disaggregation is possible as per the following Table 3 and Table 4.

Table 3: Province 2 health budget and expenditure by type of spending unit (NPR million)

Type of spending unit	2018/19			2019/20			2020/21		
	Budget	Exp	%	Budget	Exp	%	Budget	Exp	%
PHD	338.71	240.69	71	109.17	51.10	47	202.97	109.19	54
PHTC	n/a	n/a	-	30.33	21.31	70	n/a	n/a	-
PHSC	n/a	n/a	-	311.06	228.3	73	849.79	799.73	94
PPHL	n/a	n/a	-	31.98	17.42	55	85.43	77.19	90
Provincial hospitals	546.85	403.09	71	439.98	402.11	91	613.95	506.33	82
District hospitals	61.35	53.45	87	851.72	169.67	20	126.67	92.95	73
District PHOs	79.09	57.89	73	360.74	177.29	49	53.21	36.50	69
Ayurved offices	n/a	n/a	-	5.53	4.74	86	n/a	n/a	-
Total	**1,026.0**	**755.12**	**74**	**2,140.5**	**1,071.9**	**50**	**1,932.0**	**1,621.9**	**84**

Sources: Financial statements of MoSD and other provincial health entities, and OAG reports.

Notes: (i) Of 7 district hospitals, data was available only for 6 of them for FY 2018/19;

(ii) Of 8 district PHOs, data was available only for 3 of them for FY 2018/19;

(iii) For FY 2020/21, data was available for Mahottari PHO and Mahottari hospital only;

(iv) The MoSD is still in the process of collecting information from the concerned entities for FY 2020/21 and so the analysis of all entities could not be completed.

Table 4: Sudur Paschim Province health budget and expenditure by type of spending unit (NPR million)

Type of spending unit	2018/19			2019/20			2020/21		
	Budget	Exp	%	Budget	Exp	%	Budget	Exp	%
PHD	50.21	30.68	61	149.75	54.45	41	152.01	63.9	42
PHTC	7.16	6.28	88	46.17	26.47	57	65.55	38.57	59
PHSC	-	-	-	95.08	34.55	36	219.83	130.65	59
PPHL	-	-	-	27.21	16.12	59	72.94	18.68	26
Provincial hospitals									

District hospitals	69.05	64.65	94	1054.86	362.13	34	1288.74	690.1	54
District PHOs	493.86	412.4	84	754.23	450.41	60	782.94	407.31	52
Ayurved offices	2.1	1.9	91	79.1	49.73	63	96.69	64.63	67
Total	**622.38**	**515.91**	**83**	**2,206.40**	**993.85**	**45**	**2,678.7**	**1,413.8**	**53**

Sources: Financial Statements of MoSD and provincial health entities, and OAG reports.

As Tables 3 and 4 above show, budget absorption for both provinces is limited, especially for FY 2019/20 (P2 is 50% and SPP is 45%) for both provinces sampled for this FRA. FY 2018/19 was slightly better for both provinces at 83% for SPP and 74% for P2. For FY 2020/21, because the process of data collection was still ongoing, not all figures appear to be included; absorption is currently sitting at 53% for SPP and 84% for P2.

Analysis of spending unit type also reveals dramatic differences in absorption rates with underspending across all categories of spending units for the three FYs analysed. District hospitals in both provinces appeared to struggle in FY 2019/20 to spend their budgets (district hospitals in SPP spending only 34% and in P2 only 20%). This is low when compared to the district level provincial health offices, the Provincial Health Training Centres or the Provincial Health Supply Centres. Closer scrutiny of district hospital planning and budgeting arrangements and practices is needed to ascertain the cause of such low utilisation rates.

For the PHDs in the two provinces sampled, the picture is not much better. As Tables 3 and 4 show, total budget absorption rates vary dramatically for both PHDs for the FYs 2018/19 to 2020/21, with rates varying from 71% down to 41% for P2 and from 61% to 41% for SP.

FY 2019/20 for both provinces saw low utilisation rates of only 43% for P2 and 36% for SP. The PHDs appear unable to spend all resources allocated to them, pointing towards significant inefficiencies in planning and budgeting and/or in the delivery of programmes and activities at the PHD level. Capital budgets appear to perform worse than recurrent budgets for both provinces indicating the need for better costing of capital projects and/or better project management during implementation. For the recurrent budget, PHD staff indicated during our FRA data collection that staff vacancies may account for significant underspends here which then have a knock-on effect on programme and service delivery and lead to further underspends.

Table 5: Budget implementation status of provincial health directorate of Province 2 (NPR million)

Budget	FY 2018/19			FY 2019/20			FY 2020/21		
	Budget	Exp.	%	Budget	Exp	%	Budget	Exp	%
Recurrent budget	256.75	213.54	83%	99.45	48.01	48%	194.42	100.85	52
Capital budget	81.96	27.15	33%	9.72	3.09	32%	8.55	8.34	98
Total	**338.71**	**240.69**	**71%**	**109.17**	**51.10**	**47%**	**202.97**	**109.19**	**54**

Sources: Financial Statements of MoSD and other provincial health entities.

Note: Differences were found in the Province 2 PHD expenditure data provided for FY 18/19 between the PHD assessment and this FRA. Through verification with OAG report data, data provided during the PHD assessment has been used this time also.

Table 6: Budget implementation status of Sudur Paschim PHD (NPR millions)

Budget	FY 2018/19			FY 2019/20			FY 2020/21		
	Budget	Exp	%	Budget	Exp	%	Budget	Exp*	%
Recurrent budget	24.42	18.32	75%	139.62	50.74	36%	140.79	60.77	43
Capital budget	25.79	12.36	48%	10.13	3.71	37%	11.22	3.13	28
Total	**50.21**	**30.68**	**61%**	**149.75**	**54.45**	**36%**	**152.01**	**63.90**	**42**

Sources: Financial Statements of MoSD and other provincial health entities.

Weak budget credibility at the level of the MoSD has also been observed for Sudur Paschim province and the programmes that it implements directly outside the PHD or other spending units in the province. Annex C includes a table showing budget and expenditure information for 32 health initiatives directly implemented by the SPP MoSD and show budget utilisation for the FY 2020/21 just 45% for the full year. Data in Annex C was extracted from CGAS and is based on activity data for health budgets allocated directly to MoSD itself. It captures budgets and expenditures incurred directly by the MoSD in FY 2020/21. The following key observations are made:

- A total of NPR 188.85 million was allocated for 32 health activities under the MoSD for direct implementation, of which total expenditures were NPR 84.36 million (44.7%). This clearly indicates limited absorption capacity in the MoSD;
- Of the 32 activities budgeted under the MoSD, no expenditures were incurred for 13 of them, representing 41% of MoSD's budget. This reflects major limitations in programme management and delivery;
- Many of the health activities budgeted under MoSD appear to be the functional responsibility of other provincial health entities. Likewise, hospitals and district health offices are not entrusted with some functions relevant to their scope of work. Responsibility for such activities rest with the MoSD, it has meant that some services have not been provided to the provincial populations at all.

Key risks:

- Budget reliability continues to be an area of concern in the financial management of provincial health services and is a more acute issue now given the impact on provincial health services of the Covid-19 pandemic;
- Wide fluctuations are observed in the composition of provincial budget outturns with some types of facilities, such as district level hospitals, significantly underspending their budgetary allocations;
- Entities, including the Provincial Health Departments, are particularly underspent on their budgetary allocations; a fact that is all the more concerning given their role in the midst of the Covid-19 pandemic;
- Zero expenditures have been recorded against some programmes directly managed by the MoSD; these services might be more successfully implemented if they were delegated to other more appropriate provincial health entities.

Pillar 2: Transparency of public finances

Pillar 2 comprises three indicators and assesses if publications such as the budget and financial reports are comprehensive and consistent, whether there is effective coordination for access to budget at all

levels, and whether financial information is available to the public in an accessible manner. It looks at the following:

- Budget classification (PI-4) and the consistency of the classification codes used in budgeting, accounting, and reporting within the ministry. Consistent use of a sufficiently comprehensive coding structure allowing transactions to be tracked throughout the budget's formulation, execution, and reporting cycle according to administrative unit, economic category, function, and/or programme.
- Transfers to spending units (PI-7) assesses the transparency and timeliness of operating transfers from other levels of government to the field offices.
- Public access (PI-9) to financial and operational information.

Main issues identified in the Provincial FRA 2020

- Funds used in the provincial sphere do not reflect needs captured in the provincial development plans as plans are still not finalised or approved. As a result, funds may not be used for intended purposes and/or realise value for money.
- Public access to limited information in publicly available budget documentation means funds may not be properly accounted for.
- Off-budget projects, not accounted for, are likely to have recurrent cost implications in the medium-long term. Absence of full information may have an adverse effect on plans and priorities for resource allocation. Fiduciary risk manifests in funds not being properly accounted for and value for money not being achieved.
- Weaknesses in the linkage between plans, policies and the budget means that funds may not be used for their intended purpose.
- Weaknesses in reporting e.g., off-budget expenditure means that funds may not be properly accounted for.

Codings and classifications used

The budget classifications used by provincial governments are from the same CoA that has been prescribed for all three tiers of government. The unified chart of accounts has been developed based on GFSM 2014 and was originally developed by the FCGO and approved by the OAG in 2017, later revised in 2019 for subnational government. It is mandatory for provincial spending units to follow this CoA. This coding convention is reflected in all financial software packages being used in the GoN at all levels including in the LMBIS, PLMBIS, FMIS. CGAS and SUTRA accounting applications. In addition, the FMoHP in 2019 developed a 'Health Chart of Activities' with greater relevance to the health sector – this is also used by provincial government as it gives more detail on health sector/sub-sector specific programmes and activities.

Access to budget in spending units

Funding for provincial government health service delivery comes from provincial own sources of revenue and from federal government transfers (see 1.5 above). The NNRFC, an independent constitutional body, determines the allocation criteria and amounts to be transferred to each province on an annual basis, prior to the start of the FY. Fiscal transfers from federal to provincial governments (via the PTCOs, which are not yet fully functional), via the DTCOs, are made on a trimesterly basis. At the beginning of each financial year, the MoF issues guidance on how different types of fiscal transfers will be disbursed and when. The MoF provides guidance on the allocation and utilisation of budgets through equalization grants and specific conditions to be followed with conditional grants. All fiscal transfers provided to the provinces are deposited into the provincial Consolidated Fund and apportioned to sector ministries in line with appropriations in the provincial budgets, as outlined in their 'red books'. The provincial MoEAP provides guidance to provincial line ministries on procedures to follow to access budgeted funds and it

issues budget authorisations to the provincial ministries at the beginning of the financial year. The Provincial Financial Procedures Act and Rules also describe these arrangements. Budgets authorised to individual spending units are paid via the Treasury Single Account (TSA) by the PTCO on submission and verification of payment requests. Provincial ministries are required to submit trimester and annual financial reports to the MoEAP and the PTCO; the PTCO consolidates them and then submits them to the FCGO, MoF and OAG.

A major source of funding is via federal health conditional grants; they are the most significant source of recurrent funding for delivery of health facilities and the delivery of health programmes at the provinces. They have been increasing in the last few years for both provinces visited on this FRA, both seeing increases in federal health conditional grants in FY 2021/22 compared to FY 2020/21. Federal health conditional grants to Province 2 increased to NPR 921.4 million in FY 2021/22 from NPR 619.3 million in FY 2020/21, an increase of 49%. In Sudur Paschim Province, federal health conditional grants increased to NPR 813.2 million in FY 2021/22 from NPR 684 million in FY 2020/21, an increase of 19%.

In recent years, these conditional grants have moved from an organisational to a programmatic structure which provides provincial health authorities with flexibility in meeting local health needs; that said, even though conditional grant budgets are allocated under programme line item, in several cases they are still tied up with specific purpose like paying salary and allowances. Guidelines have been prepared by the FMoHP and help in guiding budget allocations at the provinces and amongst LGs. It is understood that the conditional grant allocations are calculated by the FMoHP and that below the programme allocation provinces have discretion to allocate the funds across those activities that they think will meet their service delivery needs. This is a change from the previous health facility-based grants e.g., back in 2018/19 when they were facility-based line-item grants. This helps to empower provinces to make their own decisions on which provincial programmes to provide and is a positive step towards fiscal federalism.

The FRA team found that, while federal conditional grants are important for financing provincial health services, there has been little, or no justification provided by the FMoHP for the amounts provided to provinces in recent years in that funding can vary widely from year to year without explanation or rationale as seen the following Table 7 for the last 4 years where the steady increase in values slowed in FY 2020/21. While formulas are in place to calculate grants, there does not appear to be any feedback mechanism in place to help improve transparency of grant making in the FMoHP for provinces. This is in the context of increasing delegation to provinces for health care delivery in Nepal but where federal budgetary support to provincial health programmes is found to be low and where provinces are being provided with a smaller proportion of health budgets through the conditional grant mechanism, even though the value of grants to provinces increased last year.

Table 7: Federal health conditional grants to provinces (NPR million)

Financial Year	Province 2		Sudur Paschim Province	
	Amount	% Change	Amount	% Change
2018/19	561.88	-	363.71	-
2019/20	748.70	33.24 %	582.20	60.1%
2020/21	619.30	-17.28 %	684.00	17.6%
2021/22	921.40	48.78%	813.20	18.9%

Sources: FMoHP Annual Budget summaries.

Table 8: Comparison of health budgets at provinces (NPR billion)

Province	Financial Year	Total budget	MoSD budget	MoSD budget as % of total budget	Health budget	Health budget as % of total budget
Province 2	**2018/19**	29.79	3.00	10.7	0.56	1.9
	2019/20	38.72	3.99	10.3	1.12	2.9
	2020/21	33.56	6.34	15.6	1.86	5.4
	2021/22	33.79	4.42	13.1	1.81	5.4
Sudur Paschim Province	**2018/19**	25.07	3.87	15.4	1.58	6.3
	2019/20	28.16	4.70	16.7	1.21	4.3
	2020/21	33.38	6.62	19.8	2.29	6.9
	2021/22	30.34	5.89	19.4	2.67	8.8

Sources: Provincial Red Books and Budget Speeches.

Using the information in Tables 7 and 8 above, for FY 2021/22 for example, conditional grants for both provinces were NPR 921.4 million for Province 2 and NPR 813.2 million for Sudur Paschim Province, but these were only a small portion of the total provincial budgets of NPR 33.79 billion (Province 2) and NPR 30.34 billion (SPP) for that same FY, only 2.7% in each case. The proportion of health-specific financing coming via federal health grants as a percentage of provincial health budgets is shown in the following Table 9 and displays a mixed trend. In province 2 for example, funding from the federal government has dropped from over 100% to only 51%; for SPP over the same period, funding has increased slightly from 23% to 30%.

Table 9: Federal conditional grants to the two provinces as % of health budgets (NPR billion)

	Province 2			Sudur Paschim Province		
FY	Health budget	Federal conditional grants	Grants as % of health budget	Health budget	Federal conditional grants	Grants as % of health budget
2018/19	0.56	0.57	**102%**	1.58	0.36	**23%**
2019/20	1.12	0.75	**67%**	1.21	0.58	**48%**
2020/21	1.86	0.62	**33%**	2.29	0.68	**30%**
2021/22	1.81	0.92	**51%**	2.67	0.81	**30%**

At the national level, since FY 2020/21, provinces have been provided with less than 0.4% of the national budget for health services, while the federal health budget has exceeded 7%. In terms of spending units, there are around 43 spending units in the federal sphere but over 250 in the provincial sphere, including large scale provincial hospitals. This is noted also in the context of the Covid-19 pandemic whereby provinces have had to deal with its impact on a greater number of healthcare programmes that they are responsible for.

Public access to financial information

Access by the general public in particular patients, to financial and performance information regarding public health services is still limited even though access appears to be improving[4]. A stock-take of basic elements of financial information undertaken on the provincial FRA reveals that provinces are producing and publishing only very basic elements[5]. The MoSD's and/or the PHDs in both provinces should be making decisions, plans, budgets, M&E reports, and oversight and audit reports available as and when they are produced.

Budget documentation as submitted to provincial assembly for scrutiny and approval, prepared by the provincial line ministries, also appears to vary in quality and comprehensiveness across provinces as is also noted in the Federal ASP (2020) and the Provincial FRA. The major line ministries in the provincial sphere should be thoroughly transparent in how they; estimate their fiscal space, how they arrive at a prioritisation of health needs (using what information), how they allocate resources to meet those needs, how they ensure equity and value for money, what the annual workplan and budgets are when approved, how they are implemented and, at year end what the outcome has been. A combination of paper- and web-based platforms are readily available in Nepal to facilitate this.

Neither of the two MoSDs visited for this FRA have published or disseminated central ministerial financial reports through electronic and other appropriate media. The MoSDs, therefore, appear not to comply with the provisions of fiscal accountability as set out in the Financial Procedures and Fiscal Accountability Act, 2019. This Act also requires all provincial health entities to submit revenue, expenditure and deposit-related monthly statements to their respective PTCOs and MoSD. In addition, annual statements of these returns must also be submitted. The MoSDs appear not to be in compliance with this requirement. Finally, in terms of overall transparency of financial information in Nepal, the 2019 Open Budget Survey (OBS)[6] at the federal level gave Nepal a score of 41 out of 100 on budget transparency, ranking 67 out of 117 countries surveyed. It was also only awarded 22 out of 100 for public participation in the budgeting exercise. The main concerns noted by the OBS survey were around the decreased availability of budget information by not publishing in-year reports (quarterly economic bulletins) online within three months of the end of the reporting period and, failing to publish part of the year-end report. The provinces' budgeting system is not better than the federal level and would have received similar (if not worse) scores if such assessments were carried out.

Key risks:

- The unpredictability of federal funding, including the health conditional grants, will undermine sector planning and budgeting in the provincial health sectors given that ceilings for federal funding change from year to year without proper explanation;
- The health FRA team found little or no significant effort being made in the provincial health sectors to ensure transparency or accountability to the public in the decision-making processes for health planning and budgeting.

Pillar 3: Management of assets and liabilities

This pillar assesses the extent to which risks are recognised in asset management (PI-12). Debt management, a practice that is also normally assessed as part of this pillar, is not assessed here for provincial health ministry's given that they do not raise debt finance directly themselves. It does look at

[4] The FCDO Provincial FRA describes small improvements year-on-year as the new provincial structures become more established.
[5] Appendix F, FCDO Provincial FRA 2020.
[6] See reference at https://www.internationalbudget.org/open-budget-survey/country-results/2019/nepal

asset management, including recording of asset purchases, asset monitoring and disposal, and whether current practice is guided by international best practice and standards.

Main issues identified in the Provincial FRA 2020

- Weak public investment and asset management means that funds may be wasted and/or the allocation of resources may be sub-optimal.

Management of assets and liabilities

The OAG has prescribed 18 forms (Nos 401 to 418) for the recording of and accounting for assets. Of these forms, OAG form no. 407 is meant for the accounting of current assets and form no. 408 is meant for the accounting of fixed assets. The modified versions of these forms are meant to capture the original value of assets and prepare consolidated statement of assets with cumulative values. Completion of these, and maintenance of a full asset register at ministry level at provinces makes it possible to ascertain the amount of investment made on different assets and the true cost of using such assets. The GoN chart of accounts has also been updated to address the requirement for accounting assets with a separate set of coding provided for asset accounting. Up to now however, provincial health entities have not been able to implement value-based assets accounting.

The FCGO has sought the roll-out of a new application for online Public Assets Management System (PAMS) at all levels of government from FY 2020/21. This system is still to be fully implemented by the health entities of the two provinces. It is expected that provincial entities may use PAMS during the current FY 2021/22.

At the MoSD level, accounting for assets is still taking place on a unit-by-unit basis at individual spending units. This means that it is not possible to account for or report on the classes of assets held, who holds them, and other important financial information on asset management such as, purchase prices, amount of depreciation, net present value and so on. The revised approach to asset accounting will enable the spending units, including the PHD and the MoSD, to generate reports on investments in assets, categories of assets, replacement values and to help organise maintenance schedules, especially for critical assets used in life saving procedures. In addition, maintenance and depreciation costs could also feed into planning and budgeting.

OAG reports have also noted that no integrated asset reports are currently being prepared as per the Provincial Financial Procedures Act (2017), which should incorporate all fixed assets, including inventories, for all spending units under MoSD. The OAG further noted that no reports, using the prescribed formats have been prepared for the required annual assets inspection or annual report of assets and stock.

Key risks:

- Provincial governments, and in particular the MoSDs and other health spending units, are not complying with government rules and policies regarding management of assets and other capital items. This presents a serious risk to the financing of, accounting for, and management and maintenance of assets, in particular those critical categories of assets that life-saving procedures rely on in public health services;
- NPSAS compliance in financial statements preparation will not be achieved until basic assets accounting procedures and third-party liability accounting are implemented in the health sectors in the provincial sphere.

This pillar comprises three indicators and assesses the extent to which budget allocations are made in a strategic context, follow a clear and timely process involving stakeholders, and are subject to proper scrutiny and debate. This pillar looks at the following:

- Whether a medium-term perspective is applied in planning and budgeting (PI-16), and whether expenditure policy decisions which have multi-year implications are aligned with the availability of resources in the medium term.
- The budget preparation process (PI-17), and whether it is based on effective top-down and bottom-up participation, and how far it links the annual operational budget to policy objectives.
- The arrangements in place for scrutiny of the budget (PI-18), including the scrutiny and debating of the annual budget, and the time allocated to the process in terms of the ability to approve the budget before the start of each new financial year.

Main issues identified in the Provincial FRA 2020

- Weaknesses in the capacity and degree of scrutiny by the legislature of budgets may lead to funds being used for unintended purposes.
- Weaknesses in macroeconomic and fiscal forecasting may adversely impact future financial performance and service delivery. Funds may be allocated in a sub-optimal manner.
- The failure to link capital to recurrent expenditure may results in projects being implemented that cannot be accommodated by recurrent funding leading to the waste of resources and/or poor value for money.
- Weaknesses in the costing, development and use of sector plans means that resources may not be used for their intended purpose and/or wasted.

Medium term planning & budgeting

As stated in Financial Procedures Acts of both provinces visited in this FRA, the MoEAP is required to prepare an MTEF with three years' projection of revenue and expenditures within the overall guidelines of a provincial periodic plan. Up to now, these two provinces have not been able to formulate their own individual health policy documents, which should be based on their specific health needs, including their burden of disease. Province 2 has formulated its first Periodic Plan, a multi-sector plan for the province over the period FY 2019/20 to FY 2023/24. This has provided some strategic direction in the broader socio-economic development of the province. On the other hand, Sudur Paschim Province is yet to formulate a periodic plan.

Province 2 has had a draft health policy document, but it has been in draft form for the last two years. This has led to reliance, by the provincial health authorities, on the federal health policy and strategies which appear to be applied in generic terms in the province while there is an absence of their own policy with their own goals, objectives, strategies and activities. A risk of this is that province-specific health needs may not be receiving appropriate attention and resources.

The MoSDs of the provinces are mandated to set provincial health policy, design legislation, set norms, standards and procedures, and design effective M&E arrangements. However, Province 2's MoSD appears to be preoccupied with the implementation of health programmes which ought to be the responsibility of the health entities operating under the MoSD. The OAG has noted this fact by highlighting that, in FY 2019/20, health programmes worth NPR 53.21 million were implemented directly by the MoSD itself and not by the spending units under its management.

That said, the MoSD of Province 2 has made an attempt at preparing an MTEF-based plan for the period FY 2020/21 to 2023/24, in keeping with an NPC-prescribed format, and this has also been published.

For this province, while the MTEF for the period 2021/22 to 2023/24 has been published along with a budget for FY 2021/22, the MTEF seems to be a summary of the information contained in the 'red book' for FY 2021/22 but with figures added for two more FYs. This seems to have been done and made public just to show compliance with the requirements of the Inter-government Fiscal Arrangement Act. In fact, this MTEF is not able to guide the budget formulation process into the medium-term with important details like strategic direction, vision and mission.

The MoSDs of all provinces should endeavour to adopt a 3-year rolling time horizon to strategic planning and budgeting and ensure close linkages between this process and the annual planning and budgeting round, in keeping with guidance set out in the IGFA Act of 2017. Provinces are required to prepare, and annually update their MTEF which includes all major sectors in the provincial sphere.

Budget preparation process

To facilitate the process of computing the budget ceilings, the MoEAP should constitute a Resource Estimate Committee. MoEAP in turn, should provide sectoral budget ceilings by the first week of March. All the spending units under sectoral ministries are supposed to prepare their budgets and make entries into PLMBIS by the third week of April. Provincial sectoral ministries are required to consolidate the budget requests of their spending units and after having discussed with them make necessary final adjustments into the PLMBIS. Then, it will be submitted to the provincial policy and planning commission of the province and to MoEAP by the last week of April to be followed with further discussions to arrive at final budget figures, which will be then locked by MoEAP into the PLMBIS.

In Province 2, annual planning and budgeting of provincial health programmes was found not to be participative or interactive[7]. Budget ceilings are not provided to spending units in a timely way and budget estimates are submitted by provincial-level health spending units on an ad-hoc basis. The MoSD appears to prepare the plan and budget for the provincial health sector mainly through a top-down approach, taking account of demands made during the annual review workshop and within the parameters of the budget ceilings provided from the federal and provincial governments.

Budget ceilings are not provided through the MoSD during the planning and budgeting process. The PHD, like other provincial MoSD spending units, prepares its annual plan and budget in isolation using last year's budget status, new requirements and feedback received during an annual review meeting. Once the PHD budget estimates are submitted to MoSD, discussions are then held on these estimates, but the PHD have indicated that they have only received around half of the budget that they initially requested.

MoSD is also required to make entries centrally into PLMBIS for their health sector budget after consolidating the annual health budget estimates. It was noted, that from FY 2019/20, all health-related entities under MoSD were budgeted through PLMBIS and so authorisation to spend follows automatically for the various spending units.

For SPP[8], the MoSD spending units prepare their annual plans and budgets, along with any new requirements, using feedback received during the annual review meeting. For the current FY 2021/22, after receiving their ceiling from the MoSD, the PHD prepared its annual plan and submitted it to the MoSD. After internal discussions with MoSD, significant changes appear to have been made to spending units' proposed budgets. As a result, they face difficulties in implementing their annual programmes due to these changes but also due to the late communication of these changes back to them. This may lead to non-achievement of programme targets and the possibility of higher fiduciary risk through rushed implementation and bunching of expenditures at the end of the FY.

As mentioned, all of this is in addition to the fact that the MoSDs in the provinces appear to be too preoccupied with implementation of various health programmes themselves thereby undermining the role of the PHD and spending units in provincial health services delivery. This may partly explain

[7] See PPFM's Provincial Budget Assessment Report, July 2021, for more detail on this issue.
[8] Ditto.

reductions in funding for important health services in Province 2, e.g., in FY 2021/22, the overall budget for the health sector has dropped by about 3%, funding to hospitals has dropped by 20%, and funding to district health office has dropped by 4%, all despite the on-going Covid-19 pandemic.

On the other hand, the total health budget of SPP has increased by 16% in FY 2021/22, allocations to hospitals have increased by 20%, but allocations to district health offices decreased by 19%.

In terms of orderly access to budget, the FRA team found on field visits that entity-wise, health programme budget allocations for FY 2021-22 were still not approved by the MoSD. It appears that the MoSD has delayed the approval of specific annual programmes and budgets, and that this was still the case a full nine months into the FY 2020/21. This may lead to significant delays and impact the completion of programmes; it could also lead to the possibility of higher fiduciary risks through hurried implementation and bunching of expenditures at the end of the financial year. In addition, centralization of implementation of some programmes by MoSD itself may lead to the undermining of the role of the PHD and other spending units.

The corollary of weak strategic planning and an absence of a good health policy is that annual plans and budgets for provincial health sectors are not guided by, or linked to, strategies and expected results needed from a higher-level plan. Annual programmes are not planned, costed, prepared or budgeted for in keeping with the strategic direction for health in the province as a result.

The NPC recently developed a set of National Project Bank (NPB) Guidelines (2020) to help guide the planning and budgeting for specific projects in the provincial sphere. This enables provincial governments to have a quick and accessible reference point to ensure that government funded projects are identified, appraised and selected as well as prioritised in an efficient and harmonised manner. Through the NPB, projects for all sectors can be readily and thoroughly analysed, to help with effective management and optimise use of public resources. It is, however, not clear how widespread reliance amongst provinces actually is on such NPB guidance so far, this appears according to anecdotal evidence, to have resulted only in a very ad hoc selection of projects – it appears that there is still some way to go before good quality public investment management is the norm.

Scrutiny of the budget

Since the provinces were established, provincial legislature involvement in the budget preparation process appears to have been improving[9]. In some cases, the Chief Minister has provided inputs to the content of the budget but there does not appear to be any special mechanism in place in the provincial sphere for scrutiny by elected officials of the budget or of the setting of priorities. It is not clear how closely the legislature scrutinizes line ministry budgets. Public Accounts Committees have also been established in the provinces for added scrutiny, but we are not aware of a special health committee in the provinces.

The senior management team of the MoSDs including, the Secretary, Joint Secretary, Chief of Planning Division and the Chief of Finance Division are also closely involved in oversight of the MoSD and health sector budgets.

Key risks:

- Both provinces' health policies have been in draft form for the last two years. This has led to over dependency on the federal health policy and strategies which are applied in generic terms in the absence of the province's own policy and guidelines. As a result, province-specific health related issues may not be receiving appropriate attention;
- Instead of focusing on health policy, planning, enactment, developing norms and procedures and monitoring of health service delivery, the MoSDs appear to be more inclined to get involved in capital projects and in implementing health programmes;

[9] FCDO Provincial FRA, 2020.

- A 3-year MTEF type approach to prioritising health programme delivery, setting the direction for attainment of goals and objectives, and guiding the annual workplan and budgeting exercise, seems to be largely missing in the MoSDs for health services in the provincial sphere;
- The absence of comprehensive, well-costed and fully financed MoSD health plans has resulted in reductions in resources for health (for example, preventive/curative services, drugs) at a time when, hospitals and district health offices should be receiving more resources each year to combat the impact of the Covid-19 pandemic in provinces;
- Delays in release of budget ceilings to ministries, and from ministries to spending units is adversely affecting health services in the provincial sphere contributing to underspends and bunching of expenditures in the latter parts of the FY;
- Participation, by spending units, in the annual planning and budgeting exercise is found not to be transparent and participative. The MoSDs appear to take an overly top-down approach and seem to dictate spending units to the terms of their budgetary allocations.

Pillar 5: Predictability and control in budget execution

This pillar comprises four indicators and assesses the extent to which key financial management systems manage, review, and control resources in budget execution. It looks at the following dimensions:

- Effective service delivery and execution of the budget in accordance with workplans requires that spending units receive reliable information on the availability of, and access to, funds so they can control commitments and make payments for goods and services (PI-22).
- How payroll (PI-23) is managed for government staff, how changes to the payroll are handled, and how consistency with personnel records management is achieved.
- Whether procurement arrangements (PI-24) ensure that money is used effectively in acquiring inputs for, and achieving value for money in, the delivery of programmes and services.
- Whether effective internal controls are in place and complied with for non-salary expenditures (PI-25).
- Whether regular and adequate feedback is provided to management on the performance of the internal control systems, through an effective internal audit function (PI-26).

Main issues identified in the Provincial FRA 2020.

- There is a risk that own-source revenue collections are materially reduced due to limited local tax base and lack of capacity to collect them. Funds available to provinces are therefore not properly accounted for.
- Weaknesses in payroll control in the provincial spheres may mean that funds are not used for their intended purposes.
- Weaknesses in non-salary expenditure controls in the provincial spheres may mean that funds are not used for their intended purposes, misused or wasted.
- Deficiencies in internal audit may mean that funds are not properly accounted for or used for their intended purposes.
- Weaknesses identified by internal audit may not be brought to the attention of the OAG. As such, there is a risk that funds may not be properly accounted for or used for their intended purpose.
- Budget execution of provincial spending units will be in compliance with approved budget lines and economic codes; provisions made through provincial financial procedures act

and regulations; Provincial Expenditures Norms, 2019 (Province-2); specified economic classifications and guidelines of respective MoEAP in executing the new budget. Budget figures entered into the PLMBIS will be regarded as the authorization to make expenditures in consistency with set economic codes and line items. PLMBIS is interfaced with TSA to make disbursements accordingly.

Expenditure arrears

Rule 35 of the Financial Procedure Rules Act (2007) indicates that the 'competent official' that has authority to make expenses, or to release budget for expenditure, shall approve and make that expenditure or approve the release of such funds only where the amount is within the approved budget, the transaction falls under the concerned expenditure heading and where the amount is in respect of any particular project or programme that has already been approved. Under the TSA system, while spending units do not have to prepare cashflow projections, they are under TSA rules, supposed to submit to PTCOs, a calendar of budget expenditures, annual estimated expenditures and a statement on the annual procurement plan with commitments. PTCO disbursement approvals will then be based on this information. In the case that spending units find this projection of expenditures insufficient, the PTCOs should be updated on spending units revised estimated expenditures. While no such practices were observed through the provincial spending units, the PTCOs are controlling expenditures against payment orders within the limits set in PLMBIS.

So-called 'expenditure arrears' do not currently appear to be an issue in the provincial health spending units. That said, the Provincial FRA noted that staff at the PTCO are not currently preparing or using cash-flow forecasts (three provinces were surveyed for that FRA) and that while unpaid invoices are recorded there is no further active management of these.

Payroll controls

In the provincial sphere, the PTCOs maintain central records on all employees. The approved level of established posts and the posts that are actually filled are devolved to the provincial governments and any changes to these are requested by the provincial line ministries. The payroll is verified and controlled by the PTCO, as per the sanctioned posts, at the beginning of each new FY using the allotments included in the CGAS system. In the health sector, health entities providing curative services, can generate their own source of revenue from some of these services, for example, they may have two categories of sanctioned posts: one for staff in sanctioned posts funded by government resources and another category for additional staff deployed in posts approved by the governing boards of these semi-autonomous health entities and funding them from own source revenues. However, the PTCOs may not be able to verify the payroll of the staff employed using own-source revenues and this is a category with possible higher fiduciary risk, for example, including the existence of ghost employees.

The Provincial FRA 2020 noted that payroll controls could be strengthened in places in line with internal control guidelines developed by the federal government including closer monitoring and planning for future financial costs and liabilities of payroll decisions made today. There is also a need for control processes to be further developed so that reconciliation to approved organograms can take place routinely and in a timely manner. The significant numbers of vacancies remains an issue.

In SPP, some examples of payroll weaknesses noted by the OAG include the following (not exhaustive):

- Of 54 sanctioned posts in the MoSD, only 33 posts were filled and 21 were vacant (that is a 39% vacancy rate). This must surely undermine the performance of all MoSD assigned functions;
- According to HR data made available by the MoSD, it was found that a total of 398 different level health staff posts were sanctioned by provincial governments of which only 244 (61%) were filled (as of April 2021); and

- The current approach of leaving sanctioned posts vacant whilst recruiting more staff on temporary service contracts, all without undertaking a thorough O&M survey will lead to distortions in the HR systems of the province.

Procurement

Procurement is an area that requires improvement in the provincial sphere given limited capacity amongst the provinces in this area[10]. The Provincial FRA notes, for example, in the OAG's report for FY 2018/19 that significant procurement occurred without compliance to procurement laws and procedures.

The OAG has noted in successive reports the splitting of procurements into smaller items to allow for direct purchase, to by-pass regulations has become a regular occurrence. However, procurement planning is noted as an area that needs considerable strengthening especially in the health sectors of the two provinces visited for this FRA.

The OAG Report further noted that Province 2 did not have an annual procurement plan and the procurement unit was not operational. Annual procurement plans should ideally be developed by the provinces and linked to their respective plans and budgets.

For the provincial health sectors, the OAG noted in their reports for FYs 2018/19 and 2019/20, the following examples of the types of issues related to health sector procurement:

- that no documentation was submitted on the methods used to compute cost estimates during tendering processes;
- that proper documentation was not submitted to verify whether goods supplied were in compliance with contractual specifications stated in tender documents;
- that NPR 112.74 million was paid for the supply of ultrasound machines that should have been supplied by companies in the USA but were delivered from the Netherlands through a Hong Kong based company;
- Procurement not done in either province based on preparation of a procurement master plan and annual procurement plan;
- Weaknesses noted in procurement of ultrasound machines for the birthing center by the PHD in SPP;
- No tax invoices collected on some procurements by the PHD in SPP;
- The absence of a system to ensure that the vehicles received from procurements are as per the approved specifications in tender documents;
- Large procurements of medicines and medicinal equipment in Province 2, worth NPR 143.44 million, where cost estimates were based on average prices received from 3 to 5 firms but where the actual procurement price of the previous year was ignored; and
- Procurements made in excess of the amounts specified in the standard bidding documents but justified on the basis of 'special circumstances'.

This FRA found that a significant major weakness was that no annual procurement plans are in place in the MoSDs. The team was informed that one PHD had prepared an Annual Procurement Plan for 2020/21 but that the file was missing and could not be shared. It appears that significant inefficiencies and capacity limitations exist in the provincial health sectors.

Internal (non-payroll) controls

Standards of internal control are important in any organisation to help in documenting systems and implementing control activities such as supervision, reconciliation and the checking of processes and transactions. In accordance with the federal FPFR Act, all government offices at the federal, provincial

[10] FCDO Provincial FRA, page 29, 2020.

and local level are required to develop internal control systems in an approved format. The Internal Control Guidelines (2020) introduced by the FCGO serve as a guideline for internal control and public financial management. Among other things, the FCGO guidelines identify the elements of internal control including the framework for internal control, risk evaluation, control activities and IT systems for controlling and monitoring the internal control systems. The FCGO guidelines explain the roles and responsibilities of different officials at different levels in implementing, maintaining and improving the internal control system.

The Provincial Financial Procedure Acts (PFPAs) require all departmental chiefs in provincial governments to introduce internal control systems to ensure activities carried out by their offices are economic, efficient and effective. The PFPAs stipulate the creation of an internal control committee headed by the chief of each office. The committee is expected to strengthen the internal control system by making sure activities are efficiently and economically performed, and are results-oriented, while also minimising financial risk, improving financial reporting, settling irregularities presented by the audit, and doing other activities to make internal control system improved and effective.

The OAG's reports for FY 2018/2019 and 2019/20 on provinces noted that some provinces repeatedly demonstrated an 'insufficient internal control system' was in place. Commitment controls and expenditure verification processes remain weak. A key issue is the use of advances that are not then regularly reviewed and settled. The OAG Report noted that "due to an absence of inbuilt internal control mechanisms, provinces are unable to ensure financial discipline and accountability".

Following federalism, all of the provinces should by now have formulated the necessary laws to align with federal laws and standards to ensure that the systems and functions of governments and responsibilities of officials are consistent. Provincial ministries and their spending units should have prepared and implemented their own internal control systems to reflect the individual nature of their work, including monitoring of those controls.

Examples of the types of internal control weaknesses observed by the OAG, in their reports on FYs 2018/19 and 2019/20, in the provinces include the following:

- Retention money refunded without having evidence of VAT adjustments;
- Advances paid worth more than NPR 1.70 million still not settled at the end of the FY;
- DSAs worth more than NPR 39,000 paid to persons other than staff members upon approval by a state minister;
- NPR 43,000 paid over and above a contract value without evidence or justification;
- Payments worth over NPR 400,000 made to a supplier who has been detected as a non-filer of VAT payments to the Inland Revenue Department;
- More than NPR 500,000 paid as 'financial assistance' but was not incorporated into the budget on PLMBIS;
- More than NPR 104,000 in excess payments resulting from non-compliance to financial rules while undertaking COVID related activities;
- Non-preparation of master and annual procurement plans;
- Non-compliance with specified line-item expenditure headings, for example, by paying meeting allowances from expenditure heads that should be for staff allowances;
- An amount of over NPR 134,000 paid to administrative staff outside of set norms for Covid-19 pandemic response related work;
- A total of NPR 2.84 million paid against submission of VAT bills to different firms that the OAG has detected as being in default of VAT regulations with the Inland Revenue Department;
- An amount of NPR 3 million of an advance made against the supply of goods to quarantine centers while no monitoring reports were available on such goods or on the accounting arrangements;

- More than NPR 267,000 paid to a member of staff against food and accommodation expenses while staying at a hotel but who was required to stay in a government quarantine as part of their duties to manage it; and
- No work or job descriptions prepared for staff members.

As per section 38 of Financial Procedures and Fiscal Accountability Act and Section 36 of Provincial Financial Procedures Act, the detail of internal control irregularities, as outlined in successive OAG reports, should be kept to the respective offices where responsibility for addressing them also rests. The MoSD in each province has asked spending units under it to regularly send updated status reports of irregularities but no responses have been received.

Internal audit

Internal audit has been defined in Financial Procedures and Fiscal Accountability Act as the inspection, testing and analysis of the relevant documents and managerial practices, compliance of laws, accounts and other transactions and procedures by the FCGO, DTCO or PTCO; which also includes overall evaluation of internal control in the context of the achievement of objectives set for the office. The PFPAs also delegate to the FCGO's office, or the specified PTCO, the responsibility for conducting internal audit of transactions of all government offices. The basis of these audits should be regularity, economy, efficiency and effectiveness.

The OAG's opinion of the effectiveness of internal audit[11] includes the following observations (not an exhaustive list):

- The professional capabilities of the personnel engaged in internal audit have been observed to be weak due to lack of management of employees engaged in internal audits;
- Audits are not conducted on a trimesterly basis as required;
- Employees are deputed to audit work without adequate training especially on public accounting rules and on the accounting systems used;
- Audits are not deemed to be independent enough given that the auditors are actually employees of the government itself; and
- Matters such as whether income and expenditure, and the accounting for these transactions, are maintained in accordance with financial rules, do not appear to be routinely tested in audits by the DTCOs/PTCOs.

The OAG has recommended that provincial governments and their spending units should design and implement their own internal control systems as well as conduct internal audits by their own separate independent internal audit departments. Separate organisational and professional groups of internal auditors should be formed. They should also have a separate organisational structure to support, and they should be arranged so as to maintain operational independence. The effectiveness of internal audit could be enhanced through attention to professional audit capacity building by preparing necessary guidelines, standards and directives, and implementing capacity development programs and supervision.

In recent developments around the professionalisation of government internal audit in Nepal, the FCGO has segregated the internal audit group from the general accounts group of staff, from FY 2021/22. An Internal Audit Handbook has been prepared by the FCGO and implemented (from FY 2021/22) and includes a code of conduct and an independence declaration for auditors.

Key risks

[11] Auditor General's Fifty-Seventh Annual Report, 2020 -Summary

- Even though payroll management appears to be satisfactory, the significant number of staff vacancies is a serious issue in all types of provincial spending units from the MoSD down to district health offices and hospitals;
- Procurement planning remains an area of high risk and will seriously undermine the delivery of reliable and well-resourced health services if not properly addressed at all levels in the provincial health system;
- There is an absence of well-documented internal control arrangements across all provinces in Nepal and the provincial health sectors do not appear to have made any progress in addressing this issue in the health sector spending units in the provinces;
- Internal audit remains an area of concern across all of the public sector in Nepal and is significantly undermined by not being fully independent or in ensuring that provincial health spending units properly respond to all observations raised in audits.

Pillar 6: Accounting and reporting

This pillar comprises three indicators and assesses financial accounting, in-year management reporting, and annual financial reporting. It considers the following dimensions:

- Reliable reporting of financial information (PI-27), which requires constant checking and verification of recording practices and strong data integrity. This indicator assesses the extent to which accounts are regularly reconciled, and the processes in place to support the integrity of financial data.
- This indicator (PI-28) assesses the quality, completeness, timeliness, and accuracy of in-year budget reports. Information on budget execution is required to facilitate performance monitoring and, where necessary, to help identify actions needed to maintain or adjust planned budget outturns.
- Annual financial reports (PI-29) are critical for accountability and transparency in financial management. This indicator assesses the extent to which annual financial statements are complete, timely and consistent with generally accepted accounting principles and standards.

Main issues identified in the Provincial FRA 2020

- When the executive does not transparently and promptly report on actual performance compared with that planned and authorised, there is a risk that unauthorised use, misdirection, misuse or wastage of resources will be hidden, or its detection delayed.
- Lack of comprehensive annual financial reports means that the independent review and public scrutiny of budget execution is not fully effective. Fiduciary risk exists as funds may not be properly accounted for, misused or wasted.

Reconciliations and data integrity

The Federal Financial Procedures and Fiscal Accountability Act (2019) and the Federal Financial Procedures and Fiscal Regulations (2020) were put into place to regulate and facilitate the financial operations of all three tiers of governance to enable them to maintain books of accounts, and prescribed reports, in OAG-approved formats. New accounting and reporting formats also prescribe the procedures and templates for cash as well as liabilities, plus commitment accounting, in accordance with Nepal Public Sector Accounting Standards (NPSAS). At the two provinces, it was noted by the OAG that NPSAS-compliant financial statements have not been prepared.

An important part of routine financial procedures are bank reconciliations which should be carried out monthly on all treasury bank accounts. It is not clear, however, how thorough and regular this is in the MoSD or in the provincial health spending units, although it is noted that the PTCO makes payments through the TSA using CGAS. For autonomous/semi-autonomous bodies, they operate their own bank accounts for own-source revenues which are outside the CGAS/TSA arrangements.

The Provincial FRA noted that there is now a concerted effort to support the capacity building and training of accountants in the provincial sphere has also taken place and will continue under planned PFM reforms. This will focus on strengthening the integrity of financial data by, for example, ensuring that data is complete, entered onto financial systems and that reports are reconciled as part of their production.

This is also provisioned in the Nepali Constitution, and all provincial spending units are required to maintain books of accounts and prepare financial reports as per these OAG-approved formats. Several accounting and reporting formats were revised and added by

OAG in 2019 to enable accounting and reporting by the three tiers of government.

The FCGO initiated the mandatory use of the Computerised Government Accounting System (CGAS) at the federal and provincial governments from FY 2020/21 – it has now been adopted as the main software application for accounting and reporting of provincial governments. PLMBIS is also used and provides authorisations to spend in the provinces and links into the CGAS system through the TSA. CGAS has provisions for accounting for appropriations, deposits and miscellaneous accounts through electronic transactions entry and processing. CGAS must now also be used to generate payment orders and vouchers for both payroll and expenses against the bill payment register.

The Transaction Accounting and Budget Control System (TABUCS) was, until recently, used in provincial health offices and is a system developed and rolled out by the FMoHP since FY 2013/14. TABUCS supports planning, budgeting, accounting and reporting on an activity basis. This planning and financial management information system also comprises of deposit module and documentation of audit management letters and irregularities. Following the announcement by the FCGO that CGAS must now be used to process all payments for FY 2021/22, the future of TABUCS is in doubt.

Up to this current FY, and before mandatory use of CGAS was announced in April/May 2021, the MoSD of both provinces used TABUCS to capture and consolidate financial data from all health entities within the provinces. At that time there was “reverse” reconciliation of TABUCS data with that contained in the FCGO’s systems, but this did not stop the FMoHP from continuing to use TABUCS in order to obtain broad financial information by programme and activity. At present, CGAS cannot yet provide this level of analysis, although recently, the FCGO made a presentation to the PPFM and PFMA-2 teams on the present status of CGAS and its on-going enhancements. It was mentioned that within the next 3 to 4 months, CGAS will be developed further to be able to generate activity-based consolidated financial and physical reports and once this is achieved, TABUCS will be redundant.

At present, CGAS, until its functionality is further developed over the coming months, can generate both line-item wise and activity-based expenditure reports but at the spending unit level only. This makes it difficult for the MoSD to systematically prepare consolidated periodic financial statements which include all spending units (see below also). The FCGO has indicated that they are working on further enhancement of CGAS in the next three to four months to help with the consolidation of financial statements in the provincial sphere and to interface with SuTRA and FMIS. When this occurs, the TABUCS system will be redundant.

In-year budget reporting

The accounts of the consolidated funds of provinces should be prepared on the basis of approved formats. The PTCO’s office should prepare monthly consolidated statements by collecting income and expenditure statements from the concerned local levels, on which the accounts are then prepared and provided to the FCGO.

The PTCO is a department-level body under the provincial Ministry of Economic Affairs and Planning with responsibility for managing provincial funds. Its main role is to coordinate, with all provincial agencies, financial administration and to keep updated accounts of the Provincial Fund, and to prepare the annual consolidated financial statements for submission to the Ministry of Economic Affairs and Planning, the Office of the Financial Comptroller, and at year end to the Auditor General. In addition, this

office also facilitates budget implementation in the provincial sphere, keeps records of income and expenditure, provides directives to provincial ministries, departments and sending units regarding financial administration and also conducts internal audit.

During the FRA field observations in Province 2, it was noted that the PTCO still does not have real time access to the financial information of the provincial ministries, departments or spending units and appears to be functioning as the District Treasury Controller Office (DTCO) of Dhanusha district where all the ministries and departments are located. The limited function of this office can be seen as a major weakness in the area of Provincial Public Financial Management.

New economic classification codes (chart of accounts) as per GFSM 2014 were approved by OAG with a second revision in 2017 as indicated above under Pillar 2. This is applicable to all tiers of government and should enable reconciliation and consolidation consistently across spending units and support a uniform approach to financial reporting.

A FCGO-developed accounting manual was developed in 2016 but is believed to be more applicable to federal-level agencies. The accounting manual needs updates incorporating new and revised AG forms and revised chart of accounts to make applicable to all tiers of governance. BEK / PFMA-2 has supported the FCGO in updating the accounting manual in this regard, the draft is yet to be approved by the Cabinet of the GoN.

As indicated above, CGAS and PLMBIS are the key systems being used by the MoSD for bookkeeping and budgetary control. The MoSD, however, does not have real time access to the financial information of departments and spending units under it. To prepare monthly or trimesterly financial statements, the MoSD has to collect the financial information directly from the concerned departments and spending units. This absence of a systematic collation and reconciliation of financial data by a line ministry in the provincial sphere can be seen as a major weakness. The provincial MoSD, and other line ministries, should have access to real time data of other CGAS of departments and spending units functioning under their control, in order to have good budgetary control of resources and to perform timely preparation and reconciliation of financial information for management. We have been told that, this function is being developed by the FCGO. Nonetheless, monthly financial statements are being generated at the spending unit level but as mentioned, with no access by the MoSD to these to capture financial information from spending units.

Annual financial reports

NPSAS compliance was formally adopted by the GoN in 2009 as the basis for public sector accounting and financial reporting standards. As a result, it must be evenly applied to all levels of government and across all spending units in order to reach full NPSAS compliance in government. Provincial health spending entities are also supposed to prepare reports based on NPSAS. This requires at its most fundamental level, a modified cash basis approach to accounting in line with IPSAS. It would be an important step forward in improving consistency and comparability of financial reporting after the adoption of this standard. It has two parts: part one is on requirements and part two on ‘encouragements’. Annual financial statements can only be described as being NPSAS compliant if they comply with all the requirements of part one. On this provincial Health FRA, it was noted that none of the health entities in the provinces complied with NPSAS requirements in their annual financial statements and, in fact, appear to be more focused on dissemination of financial information of the spending units than strict adherence to accounting standards.

As per the Financial Procedures and Fiscal Accountability Act (2019), the MoSDs are required to submit their annual financial statements within four months before the end of the FY. Non-compliance with this requirement by the MoSDs was noted for FY 2019/20.

Key risks:

- CGAS, as it is currently set up, appears to enable accounts to be consolidated by budget code and source of funds but only at spending unit level; it does not support the

consolidation of financial information at a line ministry. It also lacks the ability to log, and report on, information on physical progress of programmes and activities. This makes it difficult for provincial entities to generate reports on sector specific activities' physical progress;

- The MoSD does not currently have a system in place to monitor budgetary performance of its departments and spending units so as to prepare regular financial reports to management;
- Without an electronic interface between TABUCS and CGAS, TABUCS is not able to facilitate production and scrutiny of activity-based consolidated financial statements which are useful in the provincial health sector. Emphasis should now be placed on CGAS, which is being further developed to provide the consolidated reports that are needed;
- Partial use of TABUCS amongst all provincial health spending units has caused difficulties in generating consolidated financial reports that include all health expenditures in each province. This creates a gap in full, accurate and timely consolidation of financial statements;
- Provincial governments and their spending units currently lack capacity to prepare fully compliant NPSAS financial statements. This has resulted in non-compliance with the OAG requirement to submit NPSAS-compliant financial statements for annual audit.

Pillar 7: External scrutiny and audit

This pillar comprises two indicators and assesses:

- the quality of external audit (PI-30) and;
- independent scrutiny of audit reports (PI-31).

Reliable and extensive external audit is an essential requirement for ensuring accountability and creating transparency in the use of funds. Here, the independence of the audit function and the standard and coverage of audits is assessed. This pillar also looks at the extent of independent scrutiny of audit reports on finances and operations.

Main issues identified in the Provincial FRA 2020

- Without effective and transparent follow-up on recommendations there is a risk that the OAG is regarded as ineffective. This would severely compromise this part of the PFM cycle. Without an effective OAG there is a risk that funds are not properly accounted for, are misused or wasted.
- The absence of a functioning PAC reduces the ability of the government to be held to account.

Quality of external audit

Article 241 of the Constitution of Nepal mandates the OAG to carry out the audits of all government offices of the federation and provinces, local levels and other institutions. The audits should be carried out in accordance with methods prescribed in law with due regard to the regularity, economy, efficiency, effectiveness and the propriety of audits. Article 294 of the Constitution requires the OAG, like all constitutional bodies, to submit its annual reports to the President - the President then forwards that report through the Prime Minister to the federal parliament. For provinces, their audit reports are submitted to each of the Provincial Chiefs by the OAG.

The Audit Act of 2019 sets out details on the methodology, scope of audits and the matters to be audited by the OAG, including audit of corporate bodies wholly owned by GoN, the provinces and local bodies. Audits must be carried out in accordance with an approved audit plan in keeping with the constitution

and the Audit Act and are required to be conducted in compliance with the Act, and in keeping with the Founding Principles adopted by the International Organization of Supreme Audit Institution (INTOSAI).

In FY 2018/19, the OAG carried out audits of 5,619 entities of which 998 were provincial government ministries and entities, and 81 other institutions and committees under provinces. In FY 2019/20, the OAG carried out audits of 5,462 entities of which 1,019 were provincial government ministries and entities, and 76 other institutions and committees under provinces. These included audits of constitutional bodies, all government offices in the provincial sphere, LGs, corporate bodies, committees, boards, Trust Funds, other authorities and universities. The audit work included financial, performance, environmental, disaster management & sustainable development, information & technology and special audits. Their audit methodology includes a risk assessment to inform the audit plan and then in the audit field work, completing tests of controls, sampling techniques and detailed examination of procedures in order to collect sufficient evidence.

The OAG has conducted three external audits of the provinces for FYs 2017/18, 2018/19 and 2019/20. This produced irregularities of approximately 4.3% of the audited amount (see Table 7 below).

Table 7: Total audited amounts and irregularities for provincial audits FYs 2017/18, 2018/19 and 2019/20

	Audited Amount (NPR million)			Irregularities (NPR million)			% which are irregularities		
	2017/18	2018/19	2019/20	2017/18	2018/19	2019/20	2017/18	2018/19	2019/20
Province 1	65.7	3,466.5	4,457.0	2.2	167.4	126.5	3.4	4.8	2.8
Province 2	69.4	2,573.1	3,198.6	16.5	182.5	180.6	23.7	7.1	5.6
Bagmati	27.5	3,947.5	5,109.1	0.1	98.7	72.5	0.4	2.5	1.4
Gandaki	29.6	2,389.3	3,074.7	0.1	164.5	60.4	0.2	6.9	2.0
Lumbini	20.4	3,028.4	3,964.8	0.1	94.7	94.8	0.3	3.1	2.4
Karnali	23.8	1,900.5	2,343.9	0.0	51.7	83.5	0.1	2.7	3.6
SPP	26.2	2,282.5	2,677.8	0.6	88.3	57.5	2.3	3.9	2.1
Total	**262.6**	**19,587.8**	**24,825.9**	**19.5**	**847.8**	**675.8**	**7.4**	**4.3**	**2.7**

Source: OAG reports.

A summary of the main observations of this FRA on the OAG audits of the two provinces are as follows:

Province 2

- Total audit value for 2019/20 for Province 2 was NPR 3,198.6 million, up from only NPR 69.4 million in 2017/18 and representing a huge increase in audit coverage between the two years. This is the result of many provincial spending units being established in recent years, and corresponding increases in budgets;
- Audit irregularities in P2 dropped from 23.7% of audited amount in 2017/18 to 5.6% in 2019/20, also a significant change;
- The OAG reports reiterate for the three years the statement that most 'responsible officials' audited do not respond to management letters issued to spending units; under current rules they have 35 days to respond. The result was that the initial value of audit irregularities pointed out through the preliminary audit could not be significantly reduced in the final audit report for this province;
- The total value of cumulative outstanding audit irregularities has been estimated at NPR 16.5 million at the end of FY 2017/18, NPR 182.5 million at the end of FY 2018/19, and 180.6 million at the end of FY 2019/20.

SPP

- The total value of audit work for SPP increased from NPR 26 million in FY 2017/18 to over NPR 2.6 billion in FY 2019/20 representing a huge increase in audit coverage for this province also;
- The total value of audit irregularities was reported as NPR 57.5 million in 2019/20, or 2.1% of the total audited amount, down slightly from 2.3% in 2017/18;
- It is also reported by the OAG for 2018/19 that a total of NPR 3.81 million worth of irregularities were settled by spending unit managers upon submission of management letters to them.

Key risks:

- The settlement of audit irregularities appears to be an area of concern, given that many issues were raised on audits of MoSDs, the PHDs and other health spending units. The processes and officers responsible for settling irregularities are provisioned in both the federal and provincial Financial Procedures and Fiscal Accountability Act of 2019 but implementation of this requirement appears to be slow.

3. Key risks, mitigating measures and residual risk

This section includes recommended mitigating measures that could help to protect GoN and DP resources being provided to the provincial health departments in Nepal in the short term, and which address the key risks identified in the PFM analysis section above. These measures could also contribute to long-term strengthening of PFM systems within the provinces, in particular the line ministry of health in each province. These will enable them to better manage all resources currently received, and those it may receive in future. The mitigating measures focus on enhancing transparency, accountability and participation.

The table below sets out the fiduciary risks associated with the 7 pillars analysed in the PFM analysis above, and the suggested mitigating measures needed for each. Residual risk is defined as 'risk that remains after mitigating measures have been applied'. The level of residual risk has been calculated on the assumption that the political situation does not deteriorate, that mitigating measures are implemented effectively, that the global pandemic begins to ease, and that the level of risk is assessed at least annually through annual statements of progress (ASPs) undertaken each year after this FRA by the FCDO office in Nepal.

Table 10: Key risks, mitigating measures and residual risk

Ref	Key risks (from PFM analysis)	Suggested mitigation measures	Residual risk
Pillar 1			
1a	*Budget reliability continues to be an area of concern in the financial management of provincial health services and is a more acute issue now given the impact, on provincial health services, of the Covid-19 pandemic.*	*NHSSP PFM TA and the MoSDs in 2 provinces agree to a review of planning & budgeting arrangements prior to the start of the next planning cycle for FY 2022/23.*	*Risk remains that resources are allocated to spending units and is such a way that absorption is still too low.*
1b	*Wide fluctuations are observed in the composition of provincial budget outturns with some types of facilities, such as district level hospitals, significantly underspending their budgetary allocations.*	*A system is established, in the 2 FRA provinces to start with, to generate complete monthly budget monitoring reports for all spending units for presentation to the Secretary of MoSD and to track progress of budget implementation. Embedded NHSSP PFM TA should be able to facilitate this.*	*The budgetary monitoring system is not rolled out in time or to all spending units to ensure that it is as effective as possible.*
1c	*Entities, including the Provincial Health Departments are particularly*	*Given the new health challenges now emerging globally, key health programmes and spending units*	*Tensions between the MoSDs and PHDs and*

Ref	Key risks (from PFM analysis)	Suggested mitigation measures	Residual risk
	underspent on their budgetary allocations; a fact that is all the more concerning given their role in the midst of the Covid-19 pandemic.	*should be identified, and resources earmarked and protected for them, along with close monitoring of implementation of these budgets.*	*other spending units remain as to who does what, and which resources should go where, thereby undermining coordinated, well-resourced and closely monitored service provision.*
1d	*Zero expenditures have been recorded against some programmes directly managed by the MoSD; these services might be more successfully implemented if they were delegated to other more appropriate provincial health entities.*	*The MoSD and the NHSSP TA should urgently facilitate a service delivery review in two provinces with a view to revising roles and responsibilities in provincial health sectors. Clear assignment of responsibilities is recommended be done based on subsidiarity principle.*	*Risk that gaps and/or duplications in areas of responsibility remain and that key health services are implemented at the wrong level of administration.*
Pillar 2			
2a	*The unpredictability of federal funding, including the health conditional grants, will undermine sector planning and budgeting in the provincial health sectors given that ceilings for federal funding change from year to year without proper explanation;*	*The MoF, with help possibly from the NNRFC, and the FMoHP with NHSSP TA backstopping, agree to attempt to improve transparency in the process of how health conditional grants are calculated, allocated, released and accounted for. This will require participation, on a pilot basis of the two provinces.*	*Lack of transparency and/or lack of clarity remain on how conditional grants are managed in the national public health sector in Nepal.*
2b	*The health FRA team found little or no significant effort being made in the provincial health sectors to ensure transparency or accountability to the public in the decision-making*	*The minimum requirements of transparency in public finances are summarised and circulated to all spending units in the provincial sphere through a joint initiative led by the MoSDs. However, embedded NHSSP TA needs to support the*	*Risk remains that, even if public access to key financial information is granted, feedback from the general public into management of health*

Ref	Key risks (from PFM analysis)	Suggested mitigation measures	Residual risk
	processes for health planning and budgeting.	*development of provincial health sector specific PFM improvement plans.*	*services remains limited or non-existent.*
Pillar 3			
3a	*Provincial governments, and in particular the MoSDs and other health spending units, are not complying with government rules and policies regarding management of assets and other capital items. This presents a serious risk to the financing of, accounting for, and management and maintenance of assets, in particular those critical categories of assets that life-saving procedures rely on in public health services.*	*A thorough review of asset management policy, undertaken by the provincial MoFs, with a view to updating circulars and guidance notes where necessary for line ministries to ensure proper asset management and accounting. This could be supported through updated operating guidelines for asset management and also through capacity building of staff, particularly on NPSAS requirements.*	*Risk that provincial MoFs view this as a low priority and/or that training and guidance provided by them to line ministries is not effective.*
3b	*NPSAS compliance in financial statements preparation will not be achieved until basic assets accounting procedures and third-party liability accounting are implemented in the health sectors in the provincial sphere.*		
Pillar 4			
4a	*Both provinces' health policies have been in draft form for the last two years. This has led to over dependency on the federal health policy and strategies which are applied in generic terms in the absence of the*	*The MoSDs and the NHSSP TA should prioritise drafting of a comprehensive and costed medium term health policy and plan.*	*Risk that the development of a comprehensive and properly costed plan takes too long to inform the next planning cycle.*

Ref	Key risks (from PFM analysis)	Suggested mitigation measures	Residual risk
	province's own policy and guidelines. As a result, province-specific health related issues may not be receiving appropriate attention.		
4b	*Instead of focusing on health policy, planning, enactment, developing norms & procedures and monitoring of health service delivery, the MoSDs appear to be more inclined to get involved in capital projects and in implementing health programmes.*	*As in 1d above, the MoSD and the embedded NHSSP TA should urgently facilitate a service delivery review in two provinces with a view to revising roles and responsibilities in provincial health sectors.*	*Risk that gaps and/or duplications in areas of responsibility remain and that key health services are implemented at the wrong level of administration.*
4c	*A 3-year MTEF type approach to prioritising health programme delivery, setting the direction for attainment of goals and objectives, and guiding the annual workplan and budgeting exercise, seems to be largely missing in the MoSDs for health services in the provincial sphere.*	*The MoSDs and the NHSSP TA should prioritise drafting of a comprehensive and costed medium term health policy and plan.*	*Risk that the development of a comprehensive and properly costed plan is not sufficiently developed enough to enable an MTEF type approach to be taken in health service planning and financing.*
4d	*The absence of comprehensive, well-costed and fully financed MoSD health plans has resulted in reductions in resources for health at a time when, for example, preventive/curative services, drugs, hospitals and district health offices should be receiving more resources each year to combat the impact of the Covid-19 pandemic in provinces.*	*The MTEF-type approach to medium term planning & budgeting suggested above, will enable key priority health programmes to be identified and costed and have their resources ring-fenced and protected.*	*Important health services remain unfunded or under-funded even in light of the new global health environment.*

Ref	Key risks (from PFM analysis)	Suggested mitigation measures	Residual risk
4e	Delays in release of budget ceilings to ministries, and from ministries to spending units, is adversely affecting health services in the provincial sphere contributing to underspends and bunching of expenditures in the latter parts of the FY.	NHSSP TA and the MoSDs agree to a rapid review of planning and budgeting arrangements in the provincial health sectors to enable bottlenecks to accessing budget to be identified and resolved.	Bottlenecks in efficient and timely access to budget remain and service delivery is hampered.
4f	Participation, by spending units, in the annual planning and budgeting exercise is found not to be transparent and participative. The MoSDs appear to take an overly top-down approach and seem to dictate to spending units the terms of their budgetary allocations.	NHSSP TA and the MoSDs agree to a rapid review of planning and budgeting arrangements in the provincial health sectors to enable more effective participation by departments and spending units.	Lack of effective participation by departments and spending units in planning & budgeting remain and service delivery is not as efficient and effective as a result.
Pillar 5			
5a	Even though payroll management appears to be satisfactory, the significant number of staff vacancies is a serious issue in all types of provincial spending units from the MoSD down to district health offices and hospitals.	While payroll management seems satisfactory, the MoSDs and the NHSSP TA should urgently facilitate a service delivery review in two provinces with a view to revising staffing levels and developing a plan to fill vacancies. This may need consultation with the Public Service Commission.	Risk that limited resource availability and/or that incentives in the provincial sphere are not adequate to ensure that all key health staff posts are filled.
5b	Procurement planning remains an area of high risk and will seriously undermine the delivery of reliable and well-resourced health services if not	The MoSDs and the NHSSP TA should agree a thorough review of procurement arrangements and capacity at all levels in the provincial health sector so that consolidated procurement planning can be developed and strengthened.	Risk that responsibility for procurements is not agreed and that procurement plans are not developed in a systematic way.

Ref	Key risks (from PFM analysis)	Suggested mitigation measures	Residual risk
	properly addressed at all levels in the provincial health system.		
5c	*There is an absence of well-documented internal controls arrangements across all provinces in Nepal and the provincial health sectors do not appear to have made any progress in addressing this issue in the health sector spending units in the provinces.*	*NHSSP PFM TA (with advice from PPFM, if requested) agree with the MoSDs to undertake a thorough review of internal controls in the two provinces, starting with the MoSDs and PHDs, to develop an action plan for strengthening same.*	*Risk that wider provincial internal controls need updated and that limited progress can be made in a line ministry in improving ICs.*
5d	*Internal audit remains an area of concern across all of the public sector in Nepal and is significantly undermined by not being fully independent or in ensuring that provincial health spending units properly respond to all observations raised in audits.*	*The MoSDs to partake in a broader review and reforms process around internal audit in the provincial sphere with assistance provided by NHSSP PFM TA (and PPFM & PFMA 2 if requested). This could initially focus on better quality internal audits by the PTCOs.* *The recently prepared internal audit handbook should be updated in a reasonable time frame.* *Both the FCGO and PTCOs should publish entity wise internal audit reports for better transparency and to make the responsible officials more accountable.* *A quality assurance/peer review mechanism should be introduced to enhance the quality of the internal audits.*	*Risk that reforms to IA are slow and take a long time to gain traction, especially given resource constraints in the provincial sphere in Nepal.*
Pillar 6			

Ref	Key risks (from PFM analysis)	Suggested mitigation measures	Residual risk
6a	*CGAS, as it is currently set up, appears to enable accounts to be consolidated by budget code and source of funds but only at spending unit level; it does not support the consolidation of financial information at a line ministry or at department level. It also lacks the ability to log, and report on, information on physical progress of programmes and activities. This makes it difficult for provincial entities to generate reports on sector specific activities' physical progress.*	*PPFM, PFMA 2 and the FCGO should meet to discuss functionality limitations in the CGAS system in the provincial sphere to determine whether system enhancements can be undertaken in a reasonable timeframe to ensure systematic financial reporting.*	*Risk that the functionality of CGAS does not improve to enable comprehensive financial reporting at line ministry levels in the provinces.*
6b	*The MoSD does not currently have a system in place to monitor budgetary performance of its departments and spending units so as to prepare regular financial reports to management.*	*Discussions take place to determine whether arrangements can be established in the MoSDs to enable an action plan for full financial reporting to be completed for provincial health sectors.*	*Slow pace of discussions and lack of agreement on an interim solution mean that financial reporting is not improved significantly in the short term.*
6c	*Without an electronic interface between TABUCS and CGAS, TABUCS is not able to facilitate production and scrutiny of activity-based consolidated financial statements which are useful in the provincial health sector. Emphasis should now be placed on CGAS, which is being further developed to*	*Urgent discussions between the FCGO, NHSSP TA and PPFM to take place to consider the short-, medium- and long-term future for TABUCS in provincial financial management and reporting. This might include a strengthened interface between CGAS and TABUCS as they currently exist. TABUCS could also be used for consolidating health expenditure data on own-source revenues at all autonomous/semi-autonomous health entities*	*Slow pace of discussions and lack of agreement on an interim solution mean that financial reporting is not improved significantly in the short term.*

Ref	Key risks (from PFM analysis)	Suggested mitigation measures	Residual risk
	provide the consolidated reports that are needed.	*across the country, which is currently outside the scope of CGAS.*	
6d	*Partial use of TABUCS amongst all provincial health spending units has caused difficulties in generating consolidated financial reports that include all health expenditures in each province. This creates a gap in full, accurate and timely consolidation of financial statements.*	*Clarity is needed in the IT strategies of the provincial governments so that appropriate plans can be made to hasten the full implementation of CGAS as the main source of financial information for health service delivery.*	*Slow pace of discussions and lack of agreement on an interim solution mean that financial reporting is not improved significantly in the short term.*
6e	*Provincial governments and their spending units currently lack capacity to prepare fully compliant NPSAS financial statements. This has resulted in non-compliance with the OAG requirement to submit NPSAS-compliant financial statements for annual audit.*	*A thorough review of NPSAS compliance should be undertaken by the provincial MoFs with a view to updating circulars and guidance notes where necessary for line ministries to ensure that they comply with NPSAS requirements as far as possible. Capacity building is also needed in this regard.*	*Risk that provincial MoFs view this as a low priority and/or that training and guidance provided by them to line ministries is not effective.*
Pillar 7			
7a	*The settlement of audit irregularities appears to be an area of concern, given that many issues were raised on audits of MoSDs, the PHDs and other health spending units. The processes and officers responsible for settling irregularities are provisioned in both the federal and provincial Financial*	*Audit Rules should be adhered to so that the legal requirements of the Audit Act, relating to taking action against persons that do not submit financial statements, or do not complete audits on time, are observed.* *The provisions that require maintaining records of irregularities and clearing irregularities, specified in Financial Procedure Accountability Act 2019, should*	*Risk that provincial MoFs view this as a low priority and/or that training and guidance provided by them to line ministries is not effective.*

Ref	Key risks (from PFM analysis)	Suggested mitigation measures	Residual risk
	Procedures Accountability Act of 2019 but implementation of this requirement appears to be slow.	*be adhered to. As per audit standards, clear provision should be made to assign the authority and responsibility for conducting follow-up audits to the Auditor General and confer the responsibility to deduct the figures in irregularity records as per irregularity settlement to the concerned entity.* *The recording system for audit irregularities, and their clearance, needs to be automated and should be linked with the key performance indicators of the respective responsible person.*	

4. Financial implications of risks identified

Where possible, the FCDO FRA should consider the possible financial impact of weaknesses in PFM systems, with a view to quantifying the financial impact of the key risks identified. While predicting actual waste or losses is difficult, a first step in managing fiduciary risk is to identify the value of funds that are exposed to significant levels of risk. Matching the results of PFM diagnostics to an understanding of the flow of funds through partner country systems provides a starting point for assessing the risk of leakage or inefficiency. The table below takes each key risk identified in the PFM assessment above and attempts to identify the financial impact of each risk. From the information available, it is not always possible to quantify the potential leakage associated with each key risk, and so we have resorted to qualitative description.

Table 11: Financial implications of key risks identified

Ref	Key risks (from PFM analysis)	Potential financial impact
Pillar 1		
1a	*Budget reliability continues to be an area of concern in the financial management of provincial health services and is a more acute issue now given the impact on provincial health services, from the Covid-19 pandemic.*	*Budgets continue to be significantly underspent in provincial health sectors with over NPR 311 million (GBP £1.9 million) remaining unspent in Province 2 and nearly NPR 1.3 billion (GBP £ 7.7 million) unspent in SPP in FY 20/21.*
1b	*Wide fluctuations are observed in the composition of provincial budget outturns with some types of facilities, such as district level hospitals, significantly underspending their budgetary allocations.*	*The impact is that resources, which are already committed to programmes and spending units which cannot use them, are not available to other entities that could possibly put them to good use.*
1c	*Entities, including the Provincial Health Departments are particularly underspent on their budgetary allocations; a fact that is all the more concerning given their role in the midst of the Covid-19 pandemic.*	*The PHD in Province 2 left almost NPR 94 million unspent (used only 54% of its allocation) and the PHD in SPP left just over NPR 88 million unspent (spent only 42% of its budget) in FY 20/21. This equates to GBP £ 570k (P2) and GBP £533k (SPP) respectively.*
1d	*Zero expenditures have been recorded against some programmes directly managed by the MoSD; these services might be more successfully implemented if they were delegated to other more appropriate provincial health entities.*	*In SPP, the MoSD spent only NPR 84 million of a total budget of NPR 189 million; that is only 45% utilisation or equivalent to GBP £ 637k going unutilised.*
Pillar 2		
2a	*The unpredictability of federal funding, including the health conditional grants, will undermine sector planning and budgeting in the provincial health sectors given that ceilings for federal funding change from year to year without proper explanation;*	*Not possible to quantify in monetary terms but the lack of predictability and transparency will have a significant impact on effective, jointed-up and comprehensive planning of the financing of health services in the provinces.*

2b	*The health FRA team found little or no significant effort being made in the provincial health sectors to ensure transparency or accountability to the public in the decision-making processes for health planning and budgeting.*	*Not possible to quantify this key risk.*
Pillar 3		
3a	*Provincial governments, and in particular the MoSDs and other health spending units, are not complying with government rules and policies regarding management of assets and other capital items. This presents a serious risk to the financing of, accounting for, and management and maintenance of assets, in particular those critical categories of assets that life-saving procedures rely on in public health services.*	*Not possible to quantify this key risk, although the financial impact of a lack of assets management policy can be significant, especially when life-saving equipment and facilities are required for service provision.*
3b	*NPSAS compliance in financial statements preparation will not be achieved until basic assets accounting procedures and third-party liability accounting are implemented in the health sectors in the provincial sphere.*	
Pillar 4		
4a	*Both provinces' health policies have been in draft form for the last two years. This has led to over dependency on the federal health policy and strategies which are applied in generic terms in the absence of the province's own policy and guidelines. As a result, province-specific health related issues may not be receiving appropriate attention.*	*Not possible to quantify in financial terms this key risk, although the financial impact of the absence of a good, well-costed and sufficiently financed health policy is a fundamental flaw which will prevent the effective provision of public health services.*
4b	*Instead of focusing on health policy, planning, enactment, developing norms & procedures and monitoring of health service delivery, the MoSDs appear to be more inclined to get involved in capital projects and in implementing health programmes.*	*In SPP, the MoSD spent only NPR 84 million of a total budget of NPR 189 million; that is only 45% utilisation or equivalent to GBP £ 637k going unutilised.*
4c	*A 3-year MTEF type approach to prioritising health programme delivery, setting the direction for attainment of goals and objectives, and guiding the annual workplan and budgeting exercise, seems to be largely missing in the MoSDs for health services in the provincial sphere.*	*Not possible to quantify these risks. However, they are relevant when explaining the weak budget credibility of provincial health planning.*
4d	*The absence of comprehensive, well-costed and fully financed MoSD health plans has resulted in reductions in resources for health at a time when, for example, preventive/curative services, drugs, hospitals and district health*	

	offices should be receiving more resources each year to combat the impact of the Covid-19 pandemic in provinces.	
4e	*Delays in release of budget ceilings to ministries, and from ministries to spending units, is adversely affecting health services in the provincial sphere contributing to underspend and bunching of expenditures in the latter parts of the FY.*	
4f	*Participation, by spending units, in the annual planning and budgeting exercise is found not to be transparent and participative. The MoSDs appear to take an overly top-down approach and seem to dictate spending units to the terms of their budgetary allocations.*	
Pillar 5		
5a	*Even though payroll management appears to be satisfactory, the significant number of staff vacancies is a serious issue in all types of provincial spending units from the MoSD down to district health offices and hospitals.*	*This might contribute to the significant budgetary underspends noted above.*
5b	*Procurement planning remains an area of high risk and will seriously undermine the delivery of reliable and well-resourced health services if not properly addressed at all levels in the provincial health system.*	*Ineffective coordination and planning pf procurements from year to year will result in lower value for money as procurement packages are sent out without achieving economies of scale.*
5c	*There is an absence of well-documented internal controls arrangements across all provinces in Nepal and the provincial health sectors do not appear to have made any progress in addressing this issue in the health sector spending units in the provinces.*	*Weak internal controls are one cause of audit irregularities noted by the annual OAG external audits of provinces. These irregularities (all sectors) amounted to NPR 126.5 million in Province 2 (GBP £767k) and NPR 180.6 million in SPP (GBP £1.1m) for FY 2019/20.*
5d	*Internal audit remains an area of concern across all of the public sector in Nepal and is significantly undermined by not being fully independent or in ensuring that provincial health spending units properly respond to all observations raised in audits.*	*Not possible to quantify this risk but the level of audit irregularities and also complaints referred to the CIAA would merit urgent action in reforming IA services in the provincial sphere.*
Pillar 6		
6a	*CGAS, as it is currently set up, appears to enable accounts to be consolidated by budget code and source of funds but only at spending unit level; it does not support the consolidation of financial information at a line ministry. It also lacks the ability to log, and report on, information on physical progress of programmes and activities. This makes it*	*Not possible to quantify this risk.*

	difficult for provincial entities to generate reports on sector specific activities' physical progress.	
6b	*The MoSD does not currently have a system in place to monitor budgetary performance of its departments and spending units so as to prepare regular financial reports to management.*	*Not possible to quantify this risk.*
6c	*Without an electronic interface between TABUCS and CGAS, TABUCS is not able to facilitate production and scrutiny of activity-based consolidated financial statements which are useful in the provincial health sector. Emphasis should now be placed on CGAS, which is being further developed to provide the consolidated reports that are needed.*	*Not possible to quantify this risk.*
6d	*Partial use of TABUCS amongst all provincial health spending units has caused difficulties in generating consolidated financial reports that include all health expenditures in each province. This creates a gap in full, accurate and timely consolidation of financial statements.*	*Not possible to quantify this risk.*
6e	*Provincial governments and their spending units currently lack capacity to prepare fully compliant NPSAS financial statements. This has resulted in non-compliance with the OAG requirement to submit NPSAS-compliant financial statements for annual audit.*	*Not possible to quantify this risk.*
Pillar 7		
7a	*The settlement of audit irregularities appears to be an area of concern, given that many issues were raised on audits of MoSDs, the PHDs and other health spending units. The processes and officers responsible for settling irregularities are provisioned in both the federal and provincial Financial Procedures Accountability Act of 2019 but implementation of this requirement appears to be slow.*	*Total provincial audit irregularities (all sectors) amounted to NPR 126.5 million in Province 2 (GBP £767k) and NPR 180.6 million in SPP (GBP £1.1m) for FY 2019/20.*

5. Credibility of existing PFM reforms

Federal government

At the national level, any assessment of the credibility of reforms should be measured against seven features, as follows:

- be government led;
- be realistic and achievable;
- be integrated and effectively sequenced;
- be relevant and sustainable;
- include capacity development strategies;
- build demand for change; and
- include specific performance indicators.

As far as specific PFM reforms at a national level are concerned, the Federal ASP noted that the current government is reasonably committed to implementing multiple reforms, including the following:

- continuation with the PEFA Secretariat, which is the umbrella organisation within government on PFM matters, and which confirms the GoN's continued commitment to strengthening the PFM system and supporting the right framework; and
- development of the Integrated Public Financial Management Reform Programme which is considered the main target to assess reform for GoN and has targeted a broad set of areas for implementation going up to 2025.

Provincial government

The Provincial FRA 2020 highlighted some priority areas for strengthening PFM reforms for provinces including some of the following:

- Support needed for the GoN to review and revise the PFMRP to reflect the new government structures in Nepal;
- Ensuring effective donor co-ordination and harmonisation around PFM reform initiatives in the provincial sphere. The Provincial FRA 2020 noted that the PFM TWG group was to be revived, with quarterly meetings scheduled. This group is tasked to ensure that planned support clearly maps to the appropriate level of government;
- Monitoring of the PFMRP to ensure that the reforms are sequenced and integrated across the provincial government PFM cycle;
- For any subsequent PFMRP phases, assess the level of capacity within each province and department in order to determine the most appropriate set of reforms for each; and
- Advocate for the GoN and provincial governments to start with 'getting the basics right' before moving to more complex reforms.

As a result of our analysis of provincial health PFM arrangements, no notable efforts have been noted yet to demonstrate that provincial health entities have been attempting to implement improvements in PFM arrangements. In light of this, we suggest that the NHSSP TA, PPFM, the finance section of the FMoHP and the MoSDs of two provinces begin to pilot PFM reforms using the strategic framework for PFM reforms developed by the FMoHP as a starting point. This could be the starting point for raising awareness amongst provincial health finance staff of the need to take a structured approach to PFM reforms. The template developed by NHSSP TA lends itself to being modified by provincial governments to plan such reforms. Until the current work on developing FMIPs for selected provinces has been completed, and the NHSP TA have had time to agree these FMIPs with the respective provincial authorities, progress can be made in strengthening the financial management of resources in provincial health services.

6. Monitoring & dialogue

An FRA should not be treated as a static, one-off exercise. Maintaining a good understanding of fiduciary and corruption risk is a continuous process; hence BEK should strictly apply the SMART guide requirement that an update of the FRA is undertaken each year, in the form of an ASP.

In addition, it is important to monitor the performance of the GoN and the financial management arrangements in the provincial sphere; this is important in BEK deciding whether to provide financial aid to provinces in Nepal in the near future. BEK officials need to know what the key fiduciary risks currently are and whether planned reforms or safeguards are being implemented. There are various ways in which this can be done.

BEK guidance requires that progress in managing fiduciary risk be assessed each year and reported formally in an ASP. The ASP should highlight relevant factors pertaining to each of the fiduciary risks identified in this FRA and indicate a 'direction of travel'. It should also consider whether any new risks have emerged. The ASP will be the primary method by which BEK tracks the sector's commitment to strengthening financial management and accountability, and to reducing the risk of funds being misused through weak administration or corruption.

FCDO country offices are also required to repeat FRAs at least every three years, and to follow these up each year with an ASP. That said, this is the first 'provincial health FRA' in Nepal and it follows on from the first province-wide FRA which was completed in 2020. The first ASP of the province-wide FRA is now falling due and BEK and PFMA 2 are encouraged to ensure that this is completed.

The ASP, like the FRA, is an important process in the UK accountability mechanism – to ensure that development funds, under the management of partner countries have been used for the purposes intended. However, it is an annual exercise and needs to be accompanied by more dynamic monitoring tools. Hence, BEK should specify key milestones for any financial aid provided to provinces. Provincial financial management and governance is important for BEK in deciding whether, how much and in what form financial aid should flow to provinces in Nepal. Continuation of that support is dependent on progress in reaching agreed milestones for improvement. Where feasible, BEK should set targets for the achievement of the milestones, to assess the pace of reform. The choice of milestone should be agreed between the BEK country office and each provincial government. Other DPs are also important in this regard. After agreeing the key risks and the priority areas to be addressed (not all key risks will be dealt with at the same time), the next step should involve developing performance indicators.

As a minimum, BEK should insist on agreement around the following prior to providing financial aid to provincial health departments:

- developing a comprehensive PFM reform action plan (using the risks and mitigating actions suggested above in Table 10);
- undertaking a review of all outstanding audit observations relating to the last three years which relates directly to provincial health entities in the provinces being supported with financial aid; and
- Ensure coordination of all the above with any TA to be provided via BEK contractors in the provincial sphere.

In terms of dialogue, BEK and its DPs should continue to have regular dialogue with the government but based around a more structured approach to addressing PFM capacity building in the provincial sphere. A technical (finance) working group should be established perhaps as a sub-set of any national PFM reforms TWG and should receive support from qualified PFM reform specialists. This could be jointly led by the PEFA Secretariat in Kathmandu, have representation from the FCGO, PTCOs and DTCOs, as well as from the Finance Section of the FMoHP.

The recently developed PFM Strategic Framework, by the FMoHP, contains a useful blueprint for developing tailored PFM reforms plans for provinces and the results of this FRA and successive OAG audit reports on provinces provides more than enough evidence to develop good PFM reforms plans.

APPENDIX A: KEY FUNCTIONS OF PROVINCIAL HEALTH DIRECTORATES

- Formulate and submit the following policy, strategy, legislation, norms and guidelines for submission to MoSD:
  - Provincial health policies and strategies;
  - Long-term, medium-term and annual plans for provincial sphere health sector;
  - Provincial laws, standards, rules, regulations and guidelines in accordance with national health policy and federal legislations and guidelines;
  - Provincial strategy for the projection, development and utilisation of health-related human resources;
  - Provincial arrangements for disease control, surveillance and disaster management as per federal norms; and
  - Provincial policies, standards and guidelines for herbal preservation, promotion, promotion of quality ayurvedic drug production and regulation as per federal norms.
  - Facilitate and coordinate implementation of health-related programmes at the provincial and local level as per national policies and strategies;
- Institutionalise existing information systems in the existing health sector such as HMIS, LMIS and HIIS as integrated systems at the province level;
- Coordinate inter-province level cooperation on health issues, coordinating and facilitating technical matters with local and stakeholders;
- Support in preparing procurement plan, purchase, store and supply equipment, tools, medicines, family planning materials, vaccines and vaccine products as per the provincial requirement;
- Monitoring and reporting of public health services delivery in the provincial sphere;
- Undertake control and curbing of communicable and non-communicable diseases in the se
- Undertake works related to pharmacovigilance, proper use of medicines and antimicrobial resistance;
- Develop and implement strategy and norms for collaboration between public and private hospitals in the provincial sphere.
- Undertake works related to registration and licensing recommendation, renewal, level enhancement, monitoring and regulation of hospital, nursing home, health clinic, poly clinic and other health institutions;
- Develop and implement strategy and norms in the provincial sphere pertaining to health hazard solid waste management;
- Facilitate emergency service and reference service management in the provincial sphere;
- Support health service and institutional strengthening at the local level;
- Manage traditional health care services including Ayurvedic, Unani, Amchi, Homeopathic and Naturopathy;
- Determine and regulate standards and protocols to maintain the quality of nursing services in the provincial sphere;
- Facilitate the production and operation of quality and skilled nursing manpower;
- Assist and coordinate the implementation of provincial activities related to social security work, including health insurance;
- Support health education, information and communication systems and assist in the development and distribution of health, education, information and materials;
- Coordinate health services delivery functions both at the district and local levels; and
- Prepare a consolidated report on the delivery of health services, across the province, including local levels.

APPENDIX B: TERMS OF REFERENCE

Title of the Payment Deliverable	P 1.4 – Undertaking Fiduciary Risk Assessments (FRA) for Health Sector	Date of Approval
Team Leader	Bandhu Ranjan	23 March 2021
BEK Health Advisor	Deepak Karki	6 April 2021

Introduction & Background

PPFM, under the terms of the revised workplan, will support BEK to provide fiduciary and procurement risk oversight of NHSP3, including providing analysis and advice to BEK and the other pooled partners, KfW and Gavi. PPFM will conduct a Fiduciary Risk Assessment (FRA) every three years and an Annual Statement of Progress (ASP) each year, covering all funding through GoN and EDPs. There is a provision that BEK commission additional FRAs, if required, and if there is a change in the national systems.

There have been significant changes in the delivery of public health services in Nepal with responsibility for service delivery now allocated to the federal, provincial and municipal governments. Provinces are now an important provider of health services through the Provincial Health Directorates, Provincial Health Training Centres, Provincial Reference Labs, Provincial Health Supply Management Centres, Provincial and District Level Hospitals and District-based Provincial Health Offices which are now under the jurisdiction of the provinces. BEK now requires, as part of the recently approved workplan for PPFM, that FRA is carried out in the provincial sphere to understand fiduciary risk at this level of government, particularly in the delivery of public health services.

Purpose and Objectives

The key purpose of a provincial FRA is to assess the overall levels of fiduciary and corruption risk in the provincial health sector and to recommend measures to address any shortcomings. The specific objectives of the FRA are to:

- provide updated information of the fiduciary risk environment in provincial health sectors in general and particularly in areas of specific interest to BEK;
- make practical recommendations on mitigating risks identified;
- advise on a suitable process for monitoring performance and strengthening fiduciary capacities; and
- Assess the financial impact of risks.

Scope of Work

The FRA will cover Provincial Ministry of Social Development (PMoSD), Provincial Ministry of Health including the departments and specialised health entities at two of the three provinces to be selected from Province 2, Lumbini (5) and Sudur Paschim (7). These are the three provinces that may receive BEK, GAVI and KfW funding at a future point. The FRA will look at public financial management practices and capacity in the provincial health departments in a structured way using FCDO's 2021 FRA methodology[12] and based on other assessments and diagnostics that may be available for sub-national PFM capacity in Nepal.

The following main tasks will be carried out by the consultants:

[12] Better delivery department has updated the FRA methodology in line with Programme Rule 16 of the Performance Operating Framework (PrOF) in April 2021.

- Agree a workplan for the study within the team and with the PPFM Team Leader and Component Lead for the collection of evidence in the provincial sphere and for meetings with the main interlocutors and offices to be contacted/visited;
- Outline the documentation needed at the beginning and during the mission;
- Fully understand the financing of provincial governments including sources of funds, PFM policies and procedures, and the overall environment into which funding is made;
- Using the FCDO latest FRA Guide 2021, undertake a thorough assessment of PFM and corruption risk across the public health system in the provincial sphere;
- Identify key fiduciary and corruption risks in the provincial health department and make recommendations on mitigating measures and safeguards to address these risks, including an assessment of residual risk to government and donor funding flowing to provincial health sector;
- Analyse and assess any existing PFM reform programmes across Nepal, in the provincial sphere and in provincial health sectors, to assess their credibility;
- Analyse and assess any existing anti-corruption measures currently in place, in the provincial sphere and in provincial health sectors, to assess their credibility;
- If possible, for fiduciary and corruption risks, identify a trajectory of change in key risks;
- Review any previous similar work already conducted by BEK (for example, Provincial FRAs, SNG FMIPs) and NHSP3 (possible FA to SNG level, analysis of provincial health budgets); and
- Share the key findings to provincial governments (PHDs) and federal MoHP and to BEK.

Methodology

This FRA will use the approach and methodology set out in FCDO's latest Guide in line with Programme Rule 16 of the Performance Operating Framework (PrOF) on fiduciary risk and will also consider, where available, any other diagnostics undertaken on PFM systems at sub-national level in Nepal, including any PEFA assessments.

The FRA team will assess:

- Annual planning and budget compilation arrangements;
- Comprehensiveness of the budget;
- Budget calendar and general discipline / compliance;
- Accounting capacity;
- Compliance / knowledge of classification;
- Treasury management and banking arrangements;
- Asset management;
- Use of accounting software and understanding of associated business processes;
- Procurement management;
- Fund flow arrangements;
- Management performance and financial reporting arrangements;
- Internal control and internal audit arrangements;
- The Office of the Auditor General's external audit reports;
- Corruption risk, through review of Commission for the Investigation of Abuse of Authority (CIAA) reports and other relevant sources including COVID related issues;
- Nepal's PFM Reform Strategy (and any work on a new strategy) and how it affects the sub-national level;
- Credibility of government commitment to reform
  - Financial impact of risks
- Appropriate safeguards and mitigating measures.

Evidence will be obtained by literature review and field visit(s) in 2 provinces by carrying out interviews. PPFM will develop structured questionnaire for the researchers which will be the basis of the analysis in addition to secondary information.

Deliverables and Timeline

The deliverable (the FRA) will be an assessment report on the fiduciary risk environment in the health sector in selected provincial health departments. The outputs will include:

A. The FRA report, including an executive summary; and

B. A PPT slide deck on the main findings and recommendations (shared to BEK and Govt of Nepal).

The fieldwork will be done in June each year with a view to reporting by the end of July.

Inputs

Crown Agents will deploy appropriate international and national consultants (through the facilitation of Team Consult) for these assessments from the pool of resources included in the revised BEK-approved technical proposal. The workdays allocated for each of the assignment are as follows:

	International	National*
FRA	20	40

* Either one or two national consultants can be appointed as per the requirement to share the workload. Researchers will also be used within the above-mentioned days.

Risks

FRAs, in our experience, require scrutiny of financial documents, the collection of evidence, detailed meetings and in-depth analysis of the data and information received. This may result in findings on strengths and weaknesses of provincial PFM and anti-corruption procedures, practices and systems. Understandably, Government officials may be reluctant to provide such information and viewpoints, and may not cooperate by providing access to documents, personnel and data. Also, many of the documents may be in Nepali language thus limiting the international consultant's ability to conduct quality assurance and properly review these documents. Frequent changes in civil service appointments of officials may also hinder the assessment processes during FRA. Moreover, if corrupt practices are uncovered during the assessment, the possibility of physical threat cannot be ignored. During field missions, responsible officials may choose to take leave (or travel), citing more important tasks to be done elsewhere, when the team has planned the visit or give little or no information showing reasons to avoid further scrutiny. There is a risk that the team will not be allowed access to the documents if previous FRAs ratings are shared with the government, especially if the risk rating has deteriorated. Finally, the impact of Covid-19 travel restrictions on our ability to deliver continued good quality in our FRAs to BEK cannot be underestimated at this time.

To mitigate these risks, the work plan will be agreed with the FMoHP and will be properly disseminated to sample entities through the proper channel. The objectives of this task will be properly explained to the concerned officials of sample entities to gain their confidence. Further, both the consultant and researchers will assure them that all the information will be confidential and will be shared only with the concerned people and agencies. A circulation version will be prepared by PPFM where the risk ratings will be redacted before sharing with government counterparts and others. The version with the risk ratings will be shared with BEK only.

The country is under lockdown currently and we have planned to carry out the field work in June with the intent to finalise the report in July. There is a risk that the consultants will not be able to travel to the provinces. PPFM plans to hire consultants at the provinces to eliminate the need for consultants to travel to the provinces. The risk in this approach is that it may be difficult to find good PFM consultants residing at the provinces.

Audience and dissemination requirements

The draft FRA/ASP report, following QA by PPFM, will be shared in advance with BEK for feedback and comments. After incorporating the relevant feedback and comments, the final FRA/ASP report

will be submitted to BEK. The assessment, or a redacted version, may also be presented to provincial health departments, the FMoHP and/or other donors.

References

(i) FRA Programme Guide April 2021
(ii) National Health Policy, 2019
(iii) Joint Financing Arrangement
(iv) Previous federal and provincial FRA/ASP Reports and other EDP assessments
(v) Annual JAR Reports/FMoHP
(vi) Annual Reports of FMoHP/PDoSD
(vii) Sustainable Development Goals 2016-30
(viii) OAG/CIAA/NVC Annual Reports
(ix) 15th Periodic Plan, NPC
(x) National Health Sector Strategy, 2016-22
(xi) Annual Budgets of FMoHP/PMoSD
(xii) Provincial Financial Procedure Rules (2018)
(xiii) SNG FMIPs
(xiv) Studies on FA to SNGs
(xv) Relevant reports from GON and other DPs

APPENDIX C: MOSD HEALTH BUDGET IMPLEMENTATION IN SPP, 2020/21

Data in the following table has been extracted from CGAS and is based on activity data for health budgets allocated directly to MoSD itself. It captures budgets and expenditures incurred directly by the MoSD in FY 2020/21. The following key observations are made:

- A total of NPR 188.85 million was allocated for 32 health activities under the MoSD for direct implementation, of which total expenditures were NPR 84.36 million (44.7%). This clearly indicates limited absorption capacity in the MoSD;
- Of the 32 activities budgeted under the MoSD, no expenditures were incurred for 13 of them, representing 41% of MoSD's budget. This reflects major limitations in programme management and delivery;
- Many of the health activities budgeted under MoSD appear to be the functional responsibility of other provincial health entities. Several health activities in the table below could/should have been undertaken by the Provincial Health Directorate. Likewise, hospitals and district health offices are not entrusted with some functions relevant to their scope of work. With responsibility for such activities resting with the MoSD, it has meant that some services have not been provided to the provincial populations at all.

Health Activities Under MoSD Execution

FY 2020/21 Budget

(NPR thousands)

	Activity	Budget	Expenditures
1	Delivery care allowances	50	10
2	Risk allowance	8	-
3	Specialized doctor incentive programme	6,000	-
4	Incentive allowance to doctors, health staff and cleaners engaged in COVID pandemic relief	2,000	311
5	Study on cervical prolapse and uterus cancer in SPP	5,000	24
6	Study on maternal and child health reform in SPP	5,000	24
7	Study on change in health behaviour and usage of health services in SPP	5,000	24
8	Study and research telemedicine in hospitals and digitization in health entities of SPP	5,000	24
9	Establishment and operation of provincial ayurvedic dispensary	20,000	-
10	Strengthening of hospitals under the SPP	2,900	-
11	Equipment and HR management for provincial health promotion center	4,000	-
12	Referral service through air lifting to critical delivery and serious patients	5,000	220
13	Observation of different health days	250	-
14	Interaction on health issues to provincial assembly members	500	-

	Activity	Budget	Expenditures
15	Screening of NCD	300	-
16	Interaction on health issues with media	300	44
17	Strategic functional programme for control and management of COVID-19 and other infectious diseases	500	8
18	Free health insurance service women health volunteers	10,565	4,094
19	Free health insurance service for health workers	2,002	-
20	Free treatment of wounded people during people's revolution and armed conflict	5,000	-
21	COVID-19 management	3,538	1,346
22	Discussions on provincial health policy	500	211
23	Developing norms for the public and private entities involved in the delivery of health services	500	-
24	Formulation and printing of provincial health policy, guidelines, standards	500	398
25	Feasibility study of 15 bed hospital at Cahangruk	1,500	-
26	Emergency air lifting of Gokarna Rawal	765	765
27	MoSD Minister medical treatment	268	-
28	Grants to Gyata eye hospital for eye camp	5,400	2,160
29	Nyaya hospital (Acham) grants	70,000	60,000
30	Capital grants to Gyata eye hospital for machinery and equipment	10,000	4,000
31	Capital grants to community hospitals	4,500	1,500
32	Financial help to economically weak people	12,000	9,200
	Total	**188,846**	**84,363**

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